SOCIAL STRUCTURES OF CONTRACTS

A CASE STUDY OF THE VIETNAMESE MARKET

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Preface

This thesis is my original work. Some ideas that spring out of this research were used in collaborative work with Prof. Peter Bardsley of the Centre of Economic Theory at the University of Melbourne on game theoretical analysis of judicial bias and rent-seeking in a weak court system. Peter Bardsley and Quan Nguyen, 'Rent-seeking and Judicial Bias in Weak Legal Systems' (Working Paper, Econ. Dept. and Law School, University of Melbourne, 2004) was the result of our collaborative work. This working paper is referred to in Chapter 8 of this thesis.
ABSTRACT

What makes real life contractual arrangements? How does the law influence real life contractual arrangements? These are everyday questions for businesspeople and commercial lawyers. The traditional ‘imperative’ view of law assumes that businesspeople contract ‘in the shadow of the law’ and contractual arrangements conform to what the law says. But empirical studies on contract practice suggest that contract law may, in fact, play a very insignificant role in real life contractual arrangements. This thesis provides a sociological view of the role of contract law in real life contractual arrangements in the context of the Vietnamese market.

Specifically, this thesis applies an institutional law & economics approach to investigate how social structures of the market influence contractual arrangements to marginalize contract law in the Vietnamese market. Drawing on two surveys of contract behaviour in the Vietnamese market, this thesis finds that real life contractual arrangements respond to the institutional structure of the market as a whole, rather than only ‘the shadow of the law’. Institutional changes in the Vietnamese market suggest that there exists a merchant law system, constituted of traditional moral norms and social structures in the market. This merchant law system continues to order contractual arrangements in the market, despite the introduction of a transplanted contract law system. Disagreeing with the imperative approach, this thesis claims that contract law reform should conform to the institutional structure of the market to reduce transaction costs of contracting and to provide an effective framework for real life contractual arrangements.
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1. **Contract Governance - Catalyst for an Investigation**

When I practiced as an in-house counsel for a joint-venture leasing company in Ho Chi Minh City, Vietnam during 1996-1998, I was pre-occupied with the interrelationship between the law and other social structures of the market in real-life contractual arrangements. Designing contracts and resolving contractual disputes was the mainstay of my daily work. There were contractual problems among shareholders and directors in the joint-venture, who came from Singapore, Taiwan and Vietnam. There were contractual problems between the company and other companies and business people in Ho Chi Minh City who used the company’s services. I observed informal and relational approaches usually substituting for the legal process in the resolution of disputes. Why? Do cultural backgrounds matter in the way business people resolve commercial disputes (the Board members of this company were Singaporean, Taiwanese and Vietnamese)? Or was a cost-benefit explanation possible?

Contract law textbooks tend to mislead law students about the role of contract law in real-life business. It is a popular view among law students that the law and the legal

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1 “While economists, lawyers, and managers are familiar with the term ‘corporate governance’, very, very few of them that I have encountered have a clear idea about what it means by ‘contract governance’ and the issues embedded in the term. Contract governance is a pervasive issue in business life because the firm is, from a transaction-cost view, a bundle of contracts. In modern days, transactions are more and more cross-jurisdictional because communication and transportation technologies reduce the transaction costs of distant trade. As smaller firms enter cross-jurisdictional trade, the transaction-cost saving of the hierarchy of the firm may lose effectiveness because small firms do not have resources to create cross-jurisdictional hierarchy. I believe that contract governance should be a new and emerging field of studies to help business people deal with the problems of cross-jurisdictional and cross-cultural contracting.” – Dr. Quan H. Nguyen
process overshadow, if not determined, the process of dispute resolution. In my own experience as an in-house counsel in Ho Chi Minh City, the expectations of Directors and shareholders usually put me under pressure to find informal solutions that would resolve commercial disputes but leave unharmed the sophisticated relationships that interweave family relationships, personal relationships and reputation in the market.

In either internal disputes (those between shareholders and/or their employees) or external disputes (those between the company and outside parties), the resolution process typically began with various meetings between the counsel and members of the Board of Directors to discuss the complexity of interwoven relationships and cost-benefit side of legal action as opposed to mobilizing relational networks to settle the dispute. Preferred solutions varied according to the nature of the dispute, parties involved and private information about parties involved. And many disputes were resolved without any reference to the law and the legal process, but by moral considerations and the mobilization of outside contacts in business and political networks.

Although legal action was sometimes contemplated, in my work experience in Ho Chi Minh City, Asian merchants in the Vietnamese market tended to refer to moral norms and commercial practice in their efforts to resolve commercial disputes, and to

2 See, e.g., Marc Galanter, ‘Contract In Court; Or Almost Everything You May Or May Not Want To Know About Contract Litigation’ (2001) Wisconsin Law Review 577 (Noting that casebooks about contract law in the United States do not reflect the reality of contract litigation)

mobilize business or political networks rather than provoking the law and the legal
process. I found that my knowledge of commercial law could not - and did not -
substitute for the knowledge about the social structures of the market. I learnt that the
law is just one instrument among many instruments, and that the legal process is just
one of several processes available to settle commercial disputes.

I determined to investigate commercial contracting, and in particular contractual
arrangements and the resolution of contractual disputes in Vietnam, particularly in the
southern part of the country, the major economic hub of Vietnam. The very broad
questions provoked were, how did the Vietnamese resolve their commercial
contractual disputes and why were they resolved in that way? But further questions
emerged. What impact, if any, has recent legal reform in Vietnam had on commercial
dispute resolution and what the implications did my study have for law reform in
Vietnam?

In effect I had to undertake three key inquiries to answer these questions. First, how
do merchants actually contract and resolve their commercial contractual disputes in
the Vietnamese market? Secondly, what is the role of social institutions in shaping
contractual arrangements between local merchants in the Vietnamese market? Thirdly,
what influence, if any, has contract law reform brought to bear on the contractual
behaviour of local merchants in the Vietnamese market?

This thesis is structured to reflect these inquiries. The balance of this chapter briefly
explores some understandings of ‘Asian’ dispute resolution in the literature, noting
how a case study of contractual arrangements and resolution of contractual disputes in
the Vietnamese market can help to further these understandings. I argue here that
while the literature has identified that ‘law’ does not figure largely in resolving
disputes in Asia, the consequences of this and, more importantly, the underlying causes of this, remain under-explored.

2. ORGANIZATION OF THIS THESIS

This thesis is organized in Parts and within Chapters within Parts. Part I addresses how my question arose and key contextual material (Chapter 1), a review of relevant literature (Chapter 2) and an outline of the methodology (Chapter 3).

In Part II, the two contract ordering systems within Vietnam are set out: both formal and informal.

In Part III, the interactions and tensions between the relational and institutional structures of the market are explored, arguing that the better understanding of these has implication for law reform.

More particularly, in Chapter 2, I review the contract law literature. Looking for contract law theories to assist in answering the thesis’ inquiries led me to conflicting views about the role of contract law in shaping real-life contractual arrangements. Reviewing the contract law and private ordering literatures has reinforced the importance of my study of commercial contracting and the resolution of contractual disputes in Vietnam. This study significantly contributes to the limited understanding of the relationship between contract law and real-life contractual arrangements in the literature.

Chapter 3 outlines the methodology I have adopted. I contend that the new institutionalism offers a balanced understanding of the influences of both economic
rationality and the social structures of the market on contractual arrangements in the Vietnamese market.

Chapter 4 discusses two surveys (those of McMillan and Woodruff conducted in 1995-1997 and my own conducted in 2003-2004) concerning how merchants contract and resolve contractual disputes in the Vietnamese market. These studies investigate the interrelationship between contract practice and contract law reform in the Vietnamese market over the period of dramatic economic and legal reform in Vietnam, which began in the late 1980’s. During the decade since McMillan and Woodruff conducted their survey, economic transition in Vietnam has been accompanied by significant changes in the commercial law framework. The contract law system for commercial transactions has been developed mainly by borrowing contract law doctrines from market-oriented legal systems. In light of these legal changes it is possible to frame an inquiry that considers the extent of commercial contract law reform and its impact on contractual behaviours. By comparing the earlier findings with my own research, my analysis provokes questions about the role of social institutions that are discussed in subsequent chapters.

In Chapter 5, I investigate the reform of the contract law system in the Vietnamese market during the last decade. This chapter aims to explore how formal contract law reform took place, which model of contract law it followed, and whether the reform addresses the relational contract behaviour in the market.


5 Pham Duy Nghia, Essentials of Vietnam's Business Law (2001)

6 See further discussion in Chapter 5
In Chapters 6, I trace historical data about the market and the social structures in traditional Vietnam. This chapter explains how the market functioned in traditional Vietnam when formal laws for market transactions were not available. It also explores the role of Confucian morality as the orthodoxy of feudal rulers and pervasive ideology among the population in the functioning of the market.

In Chapter 7, I analyse informal institutional structures of the traditional and modern Vietnamese market. These social organizational structures, I argue, are capable of enforcing popular commercial norms and practices in the market, via the functioning of enforcement mechanisms embedded in these structures. These social structures combine with a popular set of commercial norms that feature basic Confucian morality to form a ‘law merchant’ in the modern Vietnamese market.

In Chapter 8, a transaction cost model of contracting is used to analyse how market players select between the contract law system as a formal institution in the market and other informal institutions in the market, using the hypothesized institutional structures of the Vietnamese market. This chapter argues that contract law reform can only help merchants to solve contracting problems if the reform of the contract law system creates a dominant institution in the market. Otherwise, the effectiveness of contract law reform can be marginalized by other market institutions.

Chapter 8 uses simple game theory models to argue that when the contract law system does not build upon the ‘law merchant’ system, incompatibility between the two contract ordering systems increases uncertainty in contractual arrangements, as well as incentives for opportunistic contract behaviour. The study of contract law reform therefore needs to be concerned not only with whether a specific agenda of contract law reform is desirable, but also whether dominant social structures in the market may
marginalize contract law reform. This affords insights on how legal reform should be designed so that the influence of contract law reform on contract behaviour to achieve the purposes of the reform would not be marginalized.

In conclusion, this study contends that contract law forms only a part of the institutional structure of the market, the overall structure of which shapes contract behaviour. This hypothesis suggests that contractual arrangements are shaped not only by contract law, but also by relationships between contract law and the institutional structure of the market. Hence, contract law reform for the Vietnamese market should not always adopt Western contract law models, but should adapt them to the existing institutional structure of the market, if it seeks effectively to be integrated into contracting behaviours.

3. LIMITED UNDERSTANDINGS OF INFORMAL COMMERCIAL PRACTICES IN ASIAN MARKETS

My personal experience with informal commercial practice of Asian merchants in the Vietnamese market has some echoes in the literature of commercial dispute resolution in Asian markets. With rise of Asian economies in the last half century, a prevalent observation of commercial practices among business circles in Southeast Asian markets is the informal approach to commercial dispute resolution. For examples, two Western-trained lawyers, discussing commercial dispute resolution in Southeast and East Asian markets, commented:
One of the much-touted characteristics of ‘Asian culture’ is the reluctance to go to law – usually interpreted as an unwillingness to mobilise formal legal process, except as a last resort, coupled with circumspection (or realism) about the limits of what a legal ‘solution’ can deliver.7

In a similar vein, the Asian Business Review giving general advice on doing business in Indonesia, advised that foreign parties should not seek to resolve their contract disputes with local partners by confrontation and adversarial procedures because Indonesians ‘prefer to settle conflicts by consultation and consensus’.8 Legal practitioners in Indonesia give similar advice.9 A Philippine arbitrator wrote that ‘most disputes in the Philippines are resolved through negotiation’ because of ‘the Filipino’s non-litigious nature and his consequent aversion to adversarial encounters, further aggravated by the costly and slow process of litigation’.10

There is a popular view in the Asian law literature that informal commercial practices in Asian markets reflect ‘an unusual and deeply rooted cultural preference for informal, mediated settlement of private disputes’.11 This approach gained popularity

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7 Veronica Taylor and Michael Pryles, 'The cultures of dispute resolution in Asia' in Michael Pryles (ed), Dispute resolution in Asia (2002)

8 T. Hudson, 'Indonesia lapses on company law', Asian business review June 1994


10 Victor P. Lazatin, 'The Philippines' in Michael Pryles (ed), Dispute resolution in Asia (1997) 175

in the Asian law literature, particularly when the role of the court process in resolving commercial disputes in Asian markets is compared with that in Western markets.  

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I contend that a generalized ‘culture’ paradigm may not be useful for the task of institutional reform, particularly commercial law reform in these Asian markets. Research conducted in 1997 under the auspices of the Asian Development Bank, an influential force of legal reform in Southeast Asian countries, on the litigation of commercial disputes in Southeast Asian countries raised this concern and called for further research that can analyse informal mechanisms of dispute resolution in specific markets:

[c]ivil and commercial litigation is a more complex matter than a simple function of the division of labor in society, add the supply of court institutions. Culture may be an important explanatory variable, but to show the relevance of culture, we would need to explain significant differences not only between East and West, but between the Republic of Korea and Taipei, China on the one hand and Japan on the other hand. Future research would also need to analyze the interaction between the propensity to litigate – within the specific environment of a given country – and outcome variables, such as the choice of contractual parties and the use of other mechanisms to settle disputes.  

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This thesis explicitly takes the practices of contracting in the Vietnamese market as the primary focus, but then connect empirical work to debates about commercial law


reform. I seek to explain the cause of informal commercial practices by analysing institutional structures of the Vietnamese market and then link my findings with an agenda for commercial contract law reform in Vietnam.

4. VIETNAM: BRIEF CONTEXT

The Vietnamese market offers an interesting case study to investigate the interaction between informal mechanisms to settle disputes and commercial law reform. In the late 1980s, Vietnam abandoned a command economy to pursue a market economy.\(^\text{14}\) During the last two decades, Vietnamese law makers have tried to bring a market that has been functioning without a formal commercial law system for centuries into the framework of formal commercial laws following Western models. Contention between indigenous commercial practices and transplanted commercial laws has been a feature of commercial law reform in this market.\(^\text{15}\)

Informal commercial practices rooted deeply in Vietnamese legal tradition. In traditional Vietnamese society, the ruler was an ethical model whose power came from a Heavenly Mandate and who regulated society according to Confucian ethical order. The law in traditional Vietnam was therefore the description of punishments for conducts that violated the ethical order. This can be seen clearly in the literature on traditional Vietnamese law.\(^\text{16}\)

\(^{14}\) See, for example, Adam Fforde and Stefan de Vylder, *From Plan to Market: The Economic Transition in Vietnam* (1996)

\(^{15}\) For recent evidence of this, see Asian Development Bank, 'Private enterprise formality and the role of local government' (Asian Development Bank, 2004); Stoyan Tenev et al, 'Informality and the Playing Field in Vietnam's Business Sector' (IFC, World Bank, MPDF, 2003)

\(^{16}\) See further discussion in Chapter 6
So, for example, the Le Code and the Nguyen Code, the two Vietnamese texts that consecutively regulated Vietnam from A.D 1483 until A.D 1931, treated conduct that violated Confucian morality as prohibited and criminal. Because Confucianism was the orthodox ideology of the time, morality was defined according to Confucian values. Confucian ideals advocated a social order, not imposed by the sovereign, but exemplified by the king acting as an ethical model. Immoral conduct was seen to be harmful to the ethical social order, and therefore punishable by sanctions prescribed by the law.

Commercial relationships were incorporated within the five core social relationships of Confucianism, namely, king-subject; farther-son; husband-wife; older brother-younger brother; and friend-friend. Traditional Vietnamese law therefore left the market unregulated, at least to the extent that commercial activities did not violate Confucian morality. Throughout this time, contractual arrangements in the traditional Vietnamese market were largely left in the realm of customary laws, village rules and moral norms. This characterisation of the Vietnamese social-market practices is taken up in more details in Chapter 6.


During the century of French occupation of Vietnam from 1859 until 1945, the French introduced their civil laws into Vietnam. But French law applied to French citizens and Europeans, indigenous and other Asiatic peoples (such as Chinese or Khmer) in Vietnam. The Nguyen Code continued to regulate the Vietnamese society during the French occupation in many aspects, including civil and commercial matters, until the French promulgated the Code of Civil and Commercial Procedure in 1931 to repeal the Nguyen Code. In the short period from 1931 to 1945, when the Viet Minh-led revolution defeated the colonial regime, there is evidence that indigenous customary laws and village rules recognized and enforced in the Nguyen Code continued to prevail over colonial civil and commercial laws due to resistance by the population against the French occupation.

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20 French occupation of Vietnam began with the capture of Gia-Dinh, the largest Southern city of Nguyen Vietnam, in February 1859. See Nguyen Khac Vien, Vietnam A Long History (1993) at 140-141


22 M.B. Hooker, A Concise Legal History of South-East Asia (1978) 153 - 83

23 M.B. Hooker, A Concise Legal History of South-East Asia (1978) 174

24 A similar argument is also found in M. Barry Hooker, ‘Law and the Chinese outside China: A preliminary survey of the issues and the literature’ in M. Barry Hooker (ed), Law and the Chinese in Southeast Asia (2002) 1 at 12 (‘[t]he idea that the colonial subjects of France should have their laws and customs incorporated into the civil system was impossible. The best that the subject peoples could hope for was some administrative acknowledgement of their laws and customs’). I discuss this point further in Chapter 6
In the early period after independence in 1945, the Democratic Republic of Vietnam continued to adopt the laws of the colonial regime. There was a short period from 1945 to 1946 when the market recovered vigorously after independence under the democratic 1946 Constitution and the favourable economic policies of the government of President Ho Chi Minh. During the 1946-54 Resistance War against the French and its allies, and the 1954-75 Unification War against the American-supported regime in Southern Vietnam, economic activities were bureaucratically commanded by the State (Democratic Republic of Vietnam) mainly for military purposes, except in Southern Vietnam where the market was busy.

After unification in 1975, the Socialist Republic of Vietnam ran a Soviet-style command economy. The 1980 Constitution and relevant economic laws did not


recognize market activities. However, it is now clear that the ‘shadow economy’, (that is, ‘illegal’ market activities according to the law of that time) was wide-spread during the command economy era, largely as a response to the errors and failures of central economic planning. For example, statistics show that the ‘shadow economy’ accounted for 20 percent to fifty percent of retail sales in Vietnam during the command economic era, despite significant risk of punishment for participants and the prohibition of the private sector under the Constitution 1980. The command economy officially ended in 1987, when Vietnam abandoned the command economy to pursue a market model. Markets and the private sector were recognized and encouraged under the Constitution passed in 1992.

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28 Constitution 1980, Chapter II

29 Xuân Trung and Quang Thiên, “Đêm trước’ đổi mới: khi chợ trời bị đánh sập (trans: The night before Reform: when the market was demolished), Tuổi Trẻ (Hồ Chí Minh City), 2/12/2005 2005, . See also Adam Fforde and Stefan de Vylder, From Plan to Market: The Economic Transition in Vietnam (1996); Vu Thu Giang and Tran Thi Thi, Women's Labour in the Informal Sector in Ha Noi - Fact and Selection (1999)

30 Vu Thu Giang and Tran Thi Thi, Women's Labour in the Informal Sector in Ha Noi - Fact and Selection (1999)


32 Compared with the 1980 Constitution, which recognized only state and collective ownership in the economic system, the 1992 Constitution in articles 15 and 16 recognized the radical change in political economic policies toward a multi-sectoral economy. Article 16 of the 1992 Constitution (as amended
Since the 1990s, Vietnam has transformed from a planned economy to the second-fastest growing market economy in the Southeast Asian region, with a dynamic private sector. In the last few years, Vietnamese law-makers have been producing a large number of commercial laws in a short period. Compared with centuries of law-making in developed legal systems such as Australia, the United Kingdom or the United States, the commercial law framework in Vietnam is being built at an incredible speed. At the same time, it is argued that economic and legal reform requires a step-by-step strategy, which results in old economic laws of the planned economy operating alongside new commercial laws drafted for a market-driven economy.

In Vietnam, building a commercial law framework for market transactions largely meant beginning from scratch, because market transactions did not officially exist under the law of Vietnam’s pre-Doi Moi command economy, and nor did laws for

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25 December 2001) reads: ‘The economic sectors constitute important components of the socialist-oriented market economy. Individuals and organizations from different economic sectors may conduct production and business in industries and trades permitted by law; may jointly carry out long-term development and co-operation, and shall be equal and shall compete in accordance with the law.’

33 The 2001 Nobel Laureate for economics, Professor Joseph Stiglitz, found Vietnam one of the two most successful transition economies among the former socialist planned economies that transformed toward market economies, the other being China. See Sergio Godoy & Joseph Stiglitz, ‘Growth, initial conditions, law and speed of privatization in transition countries: 11 years later’, August 2004, <http://www2.gsb.columbia.edu/faculty/jstiglitz/papers.cfm> at 2 September 2004


market exchange. Indeed, as argued above, the Vietnamese market has traditionally operated without the law to support contracting.

In traditional Vietnam, as I shall discuss in more detail in Chapter 6, the state left the task of regulating contracts largely to social institutions such as customs and moral codes of conduct. Law on contracts in modern Vietnam did not develop for nearly one and a half centuries from the mid Nineteenth Century to the last decades of the Twentieth Century, market institutions in Vietnam were suppressed by the French colonialist administration, resistance wars, and the anti-market command economy. As a result, tradition and morality were preferred to ‘law’ per se.

Since *Doi-Moi*, market-oriented commercial law and contract law reform has gained great momentum, as Vietnam tries to develop its markets. Further, the Vietnamese government also strives to plug the domestic economy into the world market, and, in particular, to join the World Trade Organization. So far, the reform process has largely been led by Vietnamese law-makers who received their legal education in former communist or Western legal systems. Most of the Vietnamese reformers are not familiar with their own legal traditions. To fill the gaps in market institutions, Vietnamese law-drafters tend to look toward Western legal philosophies, and eagerly

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37 Phong Lan, ‘Chày đưa với thời gian để làm luật vào WTO (trans: speeding law making to be admitted into WTO)’, *VnExpress* (Hanoi), 9/5/2005


borrow Western contract law doctrines to build a new contract law system for the Vietnamese market.  

5. **FORMAL LAW VERSUS INFORMAL COMMERCIAL PRACTICES IN THE VIETNAMESE MARKET**

It will be argued in Chapter 5 that the formal law was alien to the market, with the result that informal commercial practices in the market were strengthened. During the era of central economic planning, there was a legal vacuum for commercial exchange in the private sector, because under the centrally planned regime, individual property rights were generally not recognized. Also, commercial courts did not exist during this period. After *Doi-Moi*, Vietnamese lawmakers remain unable to speak the language of local merchants in the market. In this legal vacuum, Vietnamese

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41 See the 1980 Constitution

merchants arguably developed informal institutions to support their exchanges.\footnote{A recent report by the Far Eastern Economic Review suggests that entrepreneurs in Vietnam may use political networks to influence legal process, and to resolve commercial conflicts. See Barry Wain, 'Falling to Earth', \textit{Far Eastern Economic Review} (Ho Chi Minh City, Vietnam), May 15, 2003 \textcopyright{} 2003. See also John McMillan and Christopher Woodruff, 'Dispute Prevention Without Courts in Vietnam' (1999) 15(3) \textit{Journal of Law, Economics, and Organization} 637; John McMillan and Christopher Woodruff, 'Interim Relationships and Informal Credit in Vietnam' (1999) 114 \textit{Quarterly Journal of Economics} 1285} Since commercial laws and commercial courts were introduced in 1994, the legal vacuum has gradually narrowed, but it remains, nevertheless.\footnote{Vietnam’s 1992 Constitution, articles 15 and 21 officially recognize the existence of a private sector in the economy. The Constitution also proclaimed that private ownership is protected and the State should encourage the development of a private sector. The first contract law for commercial exchange was the Ordinance on Economic Contract, originally drafted to govern contracting activities in the public sector. The 1992 Constitution, Chapter 2} This brief review of market development and commercial law reform in Vietnam confirms a popular observation: informal commercial practices seem to avoid formal commercial laws in Vietnam.\footnote{Asian Development Bank, 'Private enterprise formality and the role of local government' (Asian Development Bank, 2004); Stoyan Tenev et al, 'Informality and the Playing Field in Vietnam's Business Sector' (IFC, World Bank, MPDF, 2003)} Contract laws in developed Western markets emerged from the social context of Western societies and are strongly influenced by Western political philosophies.\footnote{Hugh Collins, \textit{The law of contract} (1997)} Yet what is argued in this thesis is that there is a long tradition in the Vietnamese market of arranging market transactions without the support of formal laws or to avoid the effect of formal laws. Commercial law reform in Vietnam therefore faces the challenge of giving the formal law effect in real-life contractual arrangements.

\footnote{Hugh Collins, \textit{The law of contract} (1997)}
The failure of commercial law reform in Vietnam to take effect in real-life contractual arrangements has aroused scholarly interest. In the literature on commercial law reform in Vietnam, a common theme is that two decades of legal reform in Vietnam have not yet delivered a legal system that functions under the rule of law. John Gillespie, a leading commentator on the Vietnamese legal system, argues that the political ideology of the Vietnamese Communist Party is incompatible with the principles of the rule of law. This argument may not fully explain the failure of commercial law reform in Vietnam because the Vietnamese Communist Party itself strongly advocates a ‘thin’ rule of law in commercial and civil procedures, and this has been largely followed throughout the legal system.

Another common critique in the literature is that a constitutionally socialist legal system would generally do not support private commercial rights. However, since Renovation (Doi Moi) officially emanated from the top political circle in Vietnam in the late 1980s and a market economy has been recognized in the Constitution, Vietnamese law-makers have eagerly looked to developed market economies to

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borrow commercial laws for the domestic economy. The failure of commercial law reform to take effect in real-life contractual arrangements in Vietnam therefore still awaits further study.

How a study of contract law reform and contract practices in the Vietnamese market can improve our understanding of the role of contract law in real-life contractual arrangements? By asking about the role of contract law in real-life commercial transactions in the market, the question assumes that contract law influences real-life market transactions in some ways; or it may have no influence on contractual arrangements at all. However, how do we recognize if there is any influence? Ordinarily we recognize influences when there are changes. We say a factor A influences a situation B if the introduction of factor A results in the situation B being changed to C. Similarly, we can only recognize the influences of contract law in real-life market transactions if we can compare how merchants arrange their transactions in a market without contract law with how they do in a market which does have a contract law system.

In a market with an established contract law system, recognizing how contract law influences real-life contractual arrangements is difficult, because merchants have always been arranging their transactions with an awareness of the existence of a contract law system. The Vietnamese market is moving from one where formal contract law virtually did not exist, to a market where formal contract laws that mimics Western contract laws exist. Clearly this market offers an opportunity for

comparison. Comparing how contractual arrangements change between the two markets enables insight into how the newly introduced contract law system actually influences real-life market transactions, if at all.

6. METHODOLOGY FRAMED

In this thesis, as noted, I am concerned with the role of contract law in real-life commercial contractual arrangements and in the resolution of contractual disputes in Vietnam. The nature of this thesis makes it an inquiry into sociological jurisprudence, rather than analytical jurisprudence. My investigations into contract practice in the Vietnamese market led me disagree with the traditional way of teaching and studying contract law. If one agrees that the main role of contract law is to facilitate contractual arrangements in the market, then one must disagree with the view of contract law as an order imposed by the state on the market as outlined in Chapter 2. I therefore propose a sociological view of contract law, which suggests that contract law formalizes and extends the institutional structures of the market. This view, if adopted, can provide a theoretical framework for contract law reform in the Vietnamese market.

To examine the functioning of the formal contract law system in the Vietnamese market, this thesis aims to look at the system from the outside, as an institution purposefully designed by the state to support the market. This thesis will therefore not offer extensive discussions on contract law doctrines, assuming that contract law

\[51\] For the distinction between sociological jurisprudence and normative jurisprudence, see Hans Kelsen, 'The pure theory of law and analytical jurisprudence' in Hans Kelsen (ed), What is justice? Justice, law, and politics in the mirror of science - collected essays by Hans Kelsen (1957) 266. See my further discussion of this distinction in Chapter 2
doctrines as components of the whole contract law system are designed and function in the way that achieves the overall functioning purpose of the system, that is, to support contracting in the market.

Looking at the contract law system from outside does, however, raise other issues: how does the contract law system as a market institution interact with other market institutions? And how does such interaction influence the functioning of the contract law system? Research methodologies that examine the functioning of a contract law system by looking at the functioning of, and connections within, contract law doctrines do not help to answer these questions. Generally, this approached, critiqued as ‘legal centralist’ approach by law and society scholars\(^\text{52}\) ignores informal institutions, the existence of which may be very significant in determining the actual function of contract law in action.

7. RETURNING TO THE THESIS QUESTION(S)

Given the tension between informal commercial practices and formal commercial laws in the Vietnamese market, the question for legal reformers in Vietnam is: How should a contract law system be constructed to support market transactions in the Vietnamese market?

In the specific context of the Vietnamese market, since the country officially abandoned a central command economy to embark a mixed market economy in 1987, Vietnamese policy makers have seen legal reform as a key instrument to

\(^{52}\) See, for example, Marc Galanter, 'Justice in Many Rooms: Courts, Private Ordering, and Indigenous Law' (1981) 19 Journal of Legal Pluralism 1
accommodate economic growth.\textsuperscript{53} They recognize that a sound commercial law framework can facilitate the functioning of the market.\textsuperscript{54} Their aim, when borrowing modern Western commercial laws, is to facilitate market transactions.\textsuperscript{55} Their unanswered question is whether these laws do, in fact, actually facilitate real-life contractual arrangements in the market.\textsuperscript{56}

In order to suggest an agenda for contract law reform in the Vietnamese market, one must first understand how contract law reform influences real-life contractual arrangements. Economic theory suggests a nexus between institutional reform and market performance, but how this nexus performs in different institutional and social structures of the market is not fully understood.\textsuperscript{57} Contract laws in high performance markets have evolved out of the specific institutional structures of those markets, rather than following the same evolutionary model.\textsuperscript{58} For example, precedent-based contract law in the United States and Australia and codified contract law in France and Germany have arguably followed different evolutionary paths, but it is hard to


\textsuperscript{55} Pham Duy Nghia, Essentials of Vietnam's Business Law (2001)

\textsuperscript{56} See, for example, Phong Lan, 'Chạy dua với thời gian để làm luật vào WTO (trans: speeding law making to be admitted into WTO)', VnExpress (Hanoi), 9/5/2005

\textsuperscript{57} Douglass C. North, Institutions, Institutional Change, and Economic Performance (1990)

\textsuperscript{58} Huge Collins, The law of contract (1997); Hugh Collins, Regulating Contracts (1999)
differentiate the cause-effect nexuses of contract law evolution and high performance of the markets in these countries. The scholarly literature of contract law has not come up with a plausible theory (with which contract law scholars would unanimously agree) of contract law to provide a theoretical framework to draw the connections between contract law reform and market performance.  

Here it is hypothesized that contract law makes only part of the institutional structure of the market, the overall structure of which shapes contract behavior. This hypothesis suggests that contractual arrangements are shaped not only by contract law, but also by relationships between contract law and the institutional structure of the market. Hence, contract law reform for the Vietnamese market should not invariably adopt Western contract law models, but should adapt them to the existing institutional structure of the market. To test this hypothesis, this thesis comprises three main inquiries mentioned earlier: First, how do merchants actually contract and resolve their commercial contractual disputes in the Vietnamese market? Secondly, what role do social institutions play in shaping contractual arrangements of local merchants in the Vietnamese market? And thirdly, what influence has reforming contract law had on contract behavior of local merchants in the Vietnamese market?

8. THE SCOPE AND LIMITS OF THIS THESIS

This thesis begins with a view of the market where merchants transact to realize their main objective: wealth maximization.\textsuperscript{60} Transactions in the market are in the form of

\textsuperscript{59}Peter Benson (ed), \textit{The theory of contract law: new essays} (2001)

\textsuperscript{60}See, e.g., E. Farnsworth, \textit{Contracts} (1982)at 816 (noting that traditional economic theory presumes that people ‘strive to maximize their own welfare’)

contractual arrangements. Merchants are individuals or firms, that is, a group of individuals who coordinate under an organizational structure. The orthodox model of any market process would assume that merchants pursue economic efficiency, that is, they ‘seek to achieve their most preferred outcome in the least cost manner’.\(^{61}\) Cost-benefit analysis is, therefore, the dominant rationale behind the structures of contractual arrangements.

In the market, contractual arrangements can take place within a firm to economize on internal exchange, or between firms to economize on external exchanges.\(^{62}\) The economic rationale for the selection between contracting out and contracting in was examined by the Nobel Laureate Ronald H. Coase in his famous article, *The Nature Of The Firm*.\(^{63}\) From a legal perspective, internal organization is the main study of corporate laws, while external contracting is the main study of contract laws. While the line between the two areas of law is not always distinguishable in the literature, this thesis focuses on contract disputes arising from contractual arrangements outside the firm.

In this thesis, the word ‘contract’ is used in a much broader meaning than the legal contract usually understood by lawyers. A contract is defined as a vehicle for merchants to bring about an exchange for the purpose of welfare maximization. In that sense, a ‘contract’ refers to the social relationship between parties the main

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\(^{62}\) In economics, the two main ways in which economic resources are utilized to produce wealth are production and exchange. See Oliver E. Williamson, *The Economic Institutions Of Capitalism* (1985)

\(^{63}\) Ronald Coase, 'The Nature Of The Firm' (1937) *Economica* 386
function of which is to make exchange happens. Because the word ‘contract’ is not defined by legal tests that courts would follow to find a contract out of a commercial context, the ‘contract’ used in this thesis may include commercial relationships that are not recognized and enforced by courts as a ‘contract’ in legal terms.

Furthermore, the word ‘contract’ in this thesis means contractual arrangements within the commercial context. This limitation is the result of thesis question that are concerned with contractual behaviour. In analysing contractual behaviour, this thesis employs the assumption that contracting parties behave rationally to pursue wealth maximization. This assumption allows the employment of game theory models to analyse contract behaviour but it does not apply to contractual relationships in non-commercial contexts, where the many non-economic ends that people pursue may make contractual behaviour impossible to predict.
CHAPTER 2 – CONFLICTING VIEWS ABOUT CONTRACT LAW

Contract law theory is still at a nascent stage. The absence of any one plausible contract law theory is manifested in the many different views about contract law in the contract law literature. At one extreme, Grant Gilmore famously argued that contract law is dead, being swallowed by tort law. Although roundly criticized by many contract law scholars, Gilmore’s ‘the death of contract’ thesis is itself far from dead, nor was his view unique. Arguments in a similar vein can be found in the works of, for example, Lawrence Friedman, who argued that contract law was disappearing because new bodies of law would develop to regulate specialized transactions, or, more recently, Robert Scott, who argued that self-enforcement is more robust, and cheaper than formal contract law and court enforcement in real life market transactions. Yet some empiricists predict that contract law is not dead, even seemingly coming back, with more influence on the globalized market, because globalization may ‘thin’ relationships and weaken self-enforcement.

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1 See, for example, Robert A. Hillman, ‘The Crisis in Modern Contract Theory’ (1989) 67 Texas Law Review 103

2 Grant Gilmore, The Death of Contract. 1970

3 Lawrence M. Friedman, Contract law in America: A social and economic case study (1965)


5 Marc Galanter, ‘Contract in court; or almost everything you may or may not want to know about contract litigation’ (2001) Wisconsin Law Review 577 at 626 (‘In spite of the demise of classical contract doctrine, the decline of debt litigation, the spinoffs of specialized fields, and the proliferation of non-litigative controls, contract remains one of the mainstays of the litigation arena. Technology provides a swelling stream of new puzzles; legislatures provide a flow of incomplete solutions;
This chapter reviews the different views of contract law in real life market transactions, using the dichotomous taxonomy of jurisprudence proposed by Hans Kelsen: normative jurisprudence and sociological jurisprudence. In brief, the normative jurisprudence presumes an indispensable role for state coercive sanctions in the creation of a social order called the ‘law’, while sociological jurisprudence questions the efficacy of such an order. This taxonomy underlines the conflict between formal law and informal practices, which characterizes contract law reform in the Vietnamese market.

Normative jurisprudence is one stream of thought about the law that regards contracts as a piece of private law, that is, as structured rights and obligations imposed by the law on parties to an exchange. This view can be called the imperative view of contract law because it assumes that formal contract law and the shadow of the court shape real life contractual arrangements in the market. But another stream of thought, which can be called relationalism or empiricism, tends to view a contract as a bundle of ongoing relationships, which are mainly governed by supra contractual norms embedded in the social matrix of the market. The conflict between the two views of contract law reveals a question that has not been satisfactorily answered in the contract law literature: what is the role of contract law in real life contractual arrangements?


6 Hans Kelsen, 'The pure theory of law and analytical jurisprudence' in Hans Kelsen (ed), What is justice? Justice, law, and politics in the mirror of science - collected essays by Hans Kelsen (1957) 266

7 Ibid
1. **NORMATIVE JURISPRUDENCE**

Normative jurisprudence reduces the inquiry in jurisprudence to one question:
‘[w]hether a certain logically statable and describable legal order is actually operative, or by and large efficacious, over the territory for which it purports to be valid and binding?’.

This school of thought can be traced back to the social contract theory of Thomas Hobbes. Hobbes contended that in the state of nature, human nature would lead people to the ‘war of all against all’, where ‘the life of man, solitary, poor, nasty, brutish, and short’. To avoid a short life in the state of nature, according to Hobbes, people ceded their individual liberty to a sovereign in return for his protection.

Jeremy Bentham made a great contribution to practical developments of Hobbes’ social contract theory by introducing utilitarianism, the theory of mankind’s two masters: pain and pleasure, which govern human conduct. John Austin’s concept of the sovereign and Hans Kelsen’s concept of the law as a system of norms built upon the foundations of Hobbes’ and Bentham’s philosophies to fulfill the construction of a normative theory of legal systems, which serve as a major premise of normative jurisprudence.

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In normative jurisprudence, the theory of law has reached a state of completion.\textsuperscript{12} The chief tenet of the theory of legal systems in normative jurisprudence is an “imperative view” of the law: the law is a system of norms imposed by the state and backed by the state’s monopoly coercive sanctions. A law can be characterized as an ‘ought’ norm, which distinguishes law from morality, natural law, and other social norms, which can be characterized as ‘is’ norms.\textsuperscript{13} The ‘ought’ nature of the law also make legal norms superior to ‘is’ norms of morality, natural law and social norms in guiding social conducts. Kelsen argued in this regard that:\textsuperscript{14}

\begin{quote}
[t]he law of nature formulated by natural science must conform to the facts, but the facts of human action and refrainment ought to conform to the legal norms described by the science of law.
\end{quote}

This ‘ought’ characteristic of legal norms arguably gives rise to the popular view in normative jurisprudence that human conduct ultimately conforms to the law.\textsuperscript{15} According to this view, legal norms are the ultimate norms of social conduct whenever human beings, in the course of social interaction, find themselves in conflicts that require them to behave in certain ways to avoid the ‘war of all against all’. Legal norms are the ultimate norms because they are enforced by the monopoly coercive power of the state. Where there is a conflict between an ‘ought’ norm (legal


\textsuperscript{13} Hans Kelsen, 'The pure theory of law and analytical jurisprudence' in Hans Kelsen (ed), \textit{What is justice? Justice, law, and politics in the mirror of science - collected essays by Hans Kelsen} (1957) 266

\textsuperscript{14} Ibid

norm) and an ‘is’ norm (such as moral norms), the ‘ought’ norm should prevail because of its imperative power.

One representative application of normative jurisprudence is the theory of ‘bargaining in the shadow of the law’, developed by Mnookin and Kornhauser in their seminal work on bargaining in divorce cases in the U.K.\textsuperscript{16} This theory claims that divorcing spouses bargain on the basis of their estimations of what the court would give them if bargaining fails, minus court costs.\textsuperscript{17} Mnookin and Kornhauser identify three legal factors that influence outcomes of divorce bargaining:\textsuperscript{18}

1. The bargaining endowments created by legal rules;
2. The degree of uncertainty of trial outcome; and
3. Transaction costs.

Bargaining endowments for divorcing spouses are their expectations of how the court applying substantive law would decide if there is no property settlement agreement between the divorcing spouses. For the divorcing spouses, bargaining endowments can be calculated by expected trial outcome times utility of the claim and less transaction costs of litigation. Again, lawyers can figure out expected trial outcome to some degree of certainty. Transaction costs of litigation usually refer to court costs.

\textsuperscript{16} Ibid
\textsuperscript{17} Ibid
\textsuperscript{18} Ibid. Mnookin actually identified four factors as determinants of bargaining outcomes in divorce cases, the fourth factor is “the preferences of the divorcing parents”. However, this factor is subjective of the divorcing parents, not caused by the law, and therefore not commonplace in all legal disputes. For example, in commercial disputes, parties’ preference is homogeneous in term of monetary utility because, by assumption, parties behave rationally toward maximizing their economic gains.
and expenditure on legal work to produce argument and to transfer information to the court.

The ‘shadow of the law’ assumption in normative jurisprudence is also characterized by court centralism, a view of the court as the mouth of the state that speaks the law.\textsuperscript{19} For example, Peter Stein wrote:\textsuperscript{20}

\begin{quote}
[w]hen we think of the law of a modern state we have in mind a set of rules applied by courts provided by the state, whose decisions are enforced by agencies of the state such as the police.
\end{quote}

Court centralism overshadows legal theories of dispute resolution. Marc Galanter describes court centralism this way:\textsuperscript{21}

\begin{quote}
disputes require 'access' to a forum external to the original social setting of the dispute [and that] remedies will be provided as prescribed in some body of authoritative learning and dispensed by experts who operate under the auspices of the state.
\end{quote}

In dispute theories, a dispute is a conflict of interests that has evolved through a dynamic process to reach a mature stage, when claims are made and rejected in whole or in part.\textsuperscript{22} A dispute transforms into a legal dispute when claims are made based on legal norms. The court process is conveniently assumed at the end of the dispute

\begin{footnotesize}
\textsuperscript{19}M. de Secondat Montesquieu, \textit{The Spirit of Laws} (1748)
\textsuperscript{20}Peter Stein, \textit{Legal institutions: the development of dispute settlements} (1984)
\textsuperscript{21}Marc Galanter, 'Justice in Many Rooms: Courts, Private Ordering, and Indigenous Law' (1981) 19 \textit{Journal of Legal Pluralism} 1 at 1
\textsuperscript{22}Felstiner et al. (1981) defines that ‘a dispute is a claim and a rejection’. See William L. F. Felstiner, Richard L. Abel and Austin Sarat, 'The Emergence and Transformation of Disputes: Naming, Blaming, Claiming.' (1980-81) 15(3) \textit{Law & Society Review} 631 at 638
\end{footnotesize}
Jeffrey FitzGerald, for example, proposes a ‘dispute pyramid’, in which claims asserted, but not satisfied, end up in courts. Abram Chayes describes the central role of courts in what Ian Macneil later criticized as classic or neoclassic contract law as follows:

(1) The lawsuit is bipolar. Litigation is organized as a contest between two individuals or at least two unitary interests, diametrically opposed, to be decided on a winner-takes-all basis.

(2) Litigation is retrospective. The controversy is about an identified set of completed events: whether they occurred, and if so, with what consequences for the legal relations of the parties.

(3) Right and remedy are interdependent. The scope of the relief is derived more or less logically from the substantive violation under the general theory that the plaintiff will get compensation measured by the harm caused by the defendant's breach of duty - in contract by giving plaintiff the money he would have had absent the breach; in tort by paying the value of the damage caused.

(4) The lawsuit is a self-contained episode. The impact of the judgment is confined to the parties. If plaintiff prevails there is a simple compensatory transfer, usually of money, but

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24 Jeffrey FitzGerald, 'Grievances, Disputes and Outcomes: A Comparison Of Australia And The United States' (1983) 1 Law in Context 15

occasionally the return of a thing or the performance of a definite act. If defendant prevails, a
loss lies where it has fallen. In either case, entry of judgment ends the court's involvement.

(5) The process is party-initiated and party-controlled. The case is organized and the issues
defined by exchanges between the parties. Responsibility for fact development is theirs. The
trial judge is a neutral arbiter of their interactions who decides questions of law only if they
are put in issue by an appropriate move of a party.

In this model, the role of courts is to grant or to deny claims.26 A claim over a legal
right would normally constitute a cause of action before courts. Therefore, a legal
dispute is a dispute that can enter the court process to be resolved by a court decision.

My definition of ‘legal disputes’ derives from the legal conception of the cause of
action in civil litigation. In most legal systems, the court process to resolve
commercial disputes is usually civil procedure, as opposed to criminal or
administrative procedure.

Court centralism is also the presumption of a broad literature on economic analysis of
settlement and litigation. This literature conventionally began with works of William

26 Kalman Kulcsar, 'Social aspects of litigation in civil courts' in Maureen Cain and Kalman Kulcsar
(eds), Disputes and the law (1983) 85. But see Vilhelm Aubert, 'Courts And Conflict Resolution'
(1967) 11(1) The Journal of Conflict Resolution 40, arguing that disputants using courts to resolve
disputes run the risk that the court imposes a solution against the disputant’s interests. See also John T.
Noonan, Persons and Masks of the Law: Cardozo, Holmes, Jefferson, and Wythe as Makers of the
Masks (1976) discussing how courts fail to address disputants’ interests when they allow formal
classification of cases to conceal the complex preferences of disputants in the case before them.
M. Landes, John P. Gould, Richard A. Posner, and Stephen Shavell. While the early literature on settlement and litigation uses microeconomics models to analyze the settlement and litigation process, the later literature prefers game theory models to explain strategic behaviors of parties in settlement and litigation. Cooter and Rubinfeld provided a comprehensive literature review of the early trend. Daughety has provided valuable insights into the later trend.

Microeconomic analysis of settlement and litigation adopts the following approaches:

- A legal claim as an economic asset;
- The litigation process as a device, by which the claim is in effect ‘sold’ by the plaintiff to the defendant;
- The defendant can be said to purchase the plaintiff’s promise never to sue the defendant again on the same claim; and

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29 Richard Posner, 'An economic approach to legal procedure and judicial administration' (1973) 2 Journal of Legal Studies 399


31 Robert Cooter and Daniel Rubinfield, 'Economic analysis of legal disputes and their resolution' (1989) 27(3) Journal of Economic Literature 1067


33 Robert D. Cooter and Daniel L. Rubinfeld, 'Economic analysis of legal disputes and their resolution' (1989) 27 Journal of Economic Literature 1067
The sale price is zero if the case is dismissed or the defendant obtains judgment at trial - otherwise it is the amount of any judgment or settlement for the plaintiff.

This model allows litigation to be compared and contrasted with other market transactions. Accordingly, economic models were applied to the process of legal dispute resolution to evaluate the effect of economic factors on litigants. Conventional models, therefore, see ‘a legal claim as an economic asset’, a claimant as seller trying to sell his ‘right to sue’ to a respondent as buyer. If the claimant’s reservation acceptance is smaller than the respondent’s reservation offer, there is a surplus to strike a bargain, and rational disputants would settle. Conventional models implicitly assume that bargaining does not begin until the cause of legal dispute is identified, so that lawsuits can be initiated.

Based on the ‘bargaining in the shadow of the law’ premise, Priest and Klein (1984) proposed a model to predict which legal dispute can be settled and which will be litigated. Priest and Klein’s model introduces the conception of the court’s ‘decision standard’, which is based on legal precedents and the personal bias of a judge or a jury. According to the Priest and Klein model, parties form different estimations of the merit of their case based upon their individual knowledge of the facts of the dispute and their prediction of how these facts will be interpreted by the court or jury. Settlement of legal disputes depends on ‘settlement surplus’, which is the difference between a plaintiff’s and a defendant’s estimation of the merit of the case.

34 Ibid

35 George Priest and Benjamin Klein, 'The selection of disputes for litigation' (1984) 13 Journal of Legal Studies 1 at 7

36 Ibid at 8
If the settlement surplus is positive, the case will not be litigated. Priest and Klein’s model presumes that the court’s decision standard is common knowledge of parties, with the result that the settlement surplus is inelastic, at least as far as parties’ estimation of gains and losses are determined by objective legal factors. However, later literature on settlement and litigation uses game theory to analyze private information that affects parties’ prediction of the court’s decision standard.

To sum up, central to the normative jurisprudence is an imperative view of the law, which also features the jurisprudence that deals with conflict resolution. The following paragraphs explain how the imperative view of the law in dispute resolution jurisprudence can easily transform into an imperative view of contract law.

2. AN IMPERATIVE VIEW OF CONTRACT LAW

The Hobbesian approach to conflict resolution has a special link with an imperative view of contract law. The commercial world has been popularly viewed as a typical Hobbesian world of conflict of economic interests. An English Chief Justice put this bluntly:

"[i]t must be remembered that all trade is and must be in a sense selfish…what one man gains another looses. In the hand to hand war of commerce, as in the conflict of public life…men fight on without much thought of others, except a desire to excel or to defeat them.

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38 Andrew F. Daughety, 'Settlement' in B. Bouckaert and G. de Geest (eds), Encyclopedia of Law and Economics (2000) vol 5, discusses the later literature on settlement and litigation

39 Mogul Steamship Co. Ltd V. Mcgregor, Gow & Co. (1888) 21 QBD 544 at 553 per Lord Coleridge C.J
It is therefore natural to find works that take an Hobbesian approach to the law of the market in the camp of normative jurisprudence.

The imperative view of contract law in the normative jurisprudence describes contract law as a branch of the legal system, which is a social order that the state imposes on contractual arrangements and backs with coercive sanctions. Hugh Collins found this view prevalent in what he criticized as classical English contract law: the contract is what the court finds it to be, not what parties really intend their exchange relationship to be.\(^{40}\) This view is eminent in the tests of enforceability that the court applies to find a contract, and the axiomatic approach that the court takes in interpreting the contract.\(^{41}\) The imperative view of the law is, I think, the foundation for rights-based theories of contract law, which view a contract as a structure of rights and obligations and contract law as a part of a social order called ‘the law’ imposed by the state and backed by the state’s sanctions.

Contract law has long been seen as ‘the organic law of the state’s economic system – a kind of constitution for business transactions’.\(^{42}\) This depiction of contract law implicitly assumes that the shadow of contract law sets the standards of contract behavior in the market. More than an assertion, this assumption is consistent with the popular theory of ‘bargaining in the shadow of the law’, which serves as a major premise for normative theories of contract law. If this assumption is right, it follows that legal norms shape contract behaviors, and law students only need to know what


\(^{41}\) Ibid. See also Melvin A. Eisenberg, 'The theory of contracts' in Peter Benson (ed), *The theory of contract law* (2001) 206

\(^{42}\) Lawrence M. Friedman, *Contract Law In America: A Social and Economic Case Study*. 1965. at 193
the law says in order to predict how contractual arrangements are negotiated, entered and enforced in real life market transactions.

Many proposed theories of contract law discuss the “pros and cons” of alternative contract rules on the presumption that these rules would produce the intended contractual arrangements in the market, without questioning whether real life contractual arrangements may take place outside the ‘shadow of the law’. This approach is clearly evident in the law & economics analysis of contract law, which now finds itself in a sterilized land of scholarship. 43 If the ‘bargaining in the shadow of the law’ assumption holds true to all real life contractual arrangements, law students need only to read what the law says in order to know how contracts are negotiated, entered and enforced in real life market. But do real life contractual arrangements exactly reflect the ‘shadow of the law’?

3. RELATIONAL APPROACHES TO CONTRACT LAW

The imperative view of contract law in the normative jurisprudence rarely fits real life contractual relationships depicted in empirical studies of business transactions. The assumption that the shadow of contract rules shapes contract behavior and the ultimate role of courts in solving contract disputes usually does not match empirical accounts. Empirical examination of business transactions unambiguously suggests that real life contracts are often inter-woven social relationships, deeply embedded in the institutional matrix of the market; and the negotiation and enforcement of contracts are often conducted outside the shadow of the law. The last half-century has

witnessed the emergence of a contract scholarship that digs into the social roots of contracts, rather than doctrinal analysis of contract law in an attempt to re-construct a theory of contract law that can embrace the richness of social aspects of real life contracts. What this scholarship is concerned with is a real life model of contracts, and a general theory of contract law that can really shape or explain contract behavior. The following sections discuss some representative work from this literature.

4. RELATIONAL CONTRACT THEORY

The literature on relational contracts disputes with the conventional literature on contract law on the answer to one core question about contract law: What determines the content of a contract? Relational contract theorists do not see a contract as a well-defined structure of rights and obligations that makes an integral part of the private law, but rather a social relationship of ongoing nature. Karl Llewellyn, in his seminal essay What Price Contract? – An Essay In Perspective, urged the recognition of a contract as a framework in which business relations evolve and adapt to the changing environment. He put it this way:

[T]he major importance of legal contract is to provide a framework for well-nigh every type of group organization and for well-nigh every type of passing or permanent relation between individuals and groups… - a framework highly adjustable, a framework which almost never accurately indicates real working relations, but which affords a rough indication around which such relations vary, an occasional guide in cases of doubt, and a norm of ultimate appeal when the relations cease in fact to work.

The idea of contracts as relational frameworks has been developed by Ian Macneil into relational contract theory. In essence, the relational contract theory views a contract as a bundle of relations ‘not rigidly bilateral [between a promisor and a promisee] but sprawling and amorphous’. Real life contractual arrangements therefore would go beyond the boundaries of rights and obligations of neoclassical contract law doctrines such as presentation or bargain. A relational contract would also go beyond the boundaries of time set by contract law doctrines such as offer and acceptance.

The commonly agreed definition of a relational contract is an agreement within an ongoing relationship between contracting parties, who flexibly adapt their agreement to changing circumstances. Ian Macneil posited that there is a set of relational norms that govern relational contracts:

1. Role integrity (requiring consistency, involving internal conflict, and being inherently complex);
2. Reciprocity (the principle of getting something back for something given);
3. Implementation of planning;
4. Effectuation of consent;

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46 Ibid


5. Flexibility;
6. Contractual solidarity;
7. The restitution, reliance, and expectation interests (the 'linking norms');
8. Creation and restraint of power (the 'power norm');
9. Propriety of means, and
10. Harmonization with the social matrix, that is, with supra-contract norms.

Although not all scholars agree on the set of relational norms proposed by Ian Macneil, they generally acknowledge the model of relational contracts he proposed.49

Because a court of law cannot go outside the boundaries of contract law to consider all relational interests, of which many may not, in fact, derive from property rights or contractual rights, Macneil’s relational theory suggests that relational factors may dominate the role of courts in resolving contract disputes. Indeed, Macneil proposed a model of resolution of contract disputes in which the court is replaced by a dispute-resolver.50 This dispute-resolver, in Macneil’s proposal theory, is free to consider all legal or non-legal interests involved in a contract dispute, in order to adjudicate the dispute.

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49 See for example, Stewart Macaulay, 'Relational contracts floating on a sea of customs? thoughts about the ideas of Ian Macneil and Lisa Bernstein' (2000) 94(3) Northwestern University Law Review 775

Ian Macneil’s theory was, to my knowledge, the first attempt in the literature to challenge the assumption of centrality of court ordering\textsuperscript{51} in resolving contract disputes. Macneil’s ideas have, however, found support in the ‘contract law in action’ literature, as well as ‘private ordering’ literature.

5. **CONTRACT LAW-IN-ACTION**

Contract law-in-action is another challenge to the conventional assumption of court centrality. This literature asks the question: How do business people use contract law to regulate their contracts in real life business? To answer this question, contract law-in-action scholars aim to explore what is a ‘contract’ in real life business, and how business people apply contract law to real life contractual arrangements. Stewart Macaulay’s seminal study of non-contractual relations in business in the United States is usually regarded as the pioneering work of this literature.\textsuperscript{52} Macaulay examined the effects of continuing relations on the mobilization of law for business transactions and dispute resolution.\textsuperscript{53} His survey of the drafting and enforcement of contracts of about six thousand manufacturers in Wisconsin, the United States, revealed that it was usual for businessmen to use ongoing relationships, instead of legal sanctions, to induce the

\textsuperscript{51} The term ‘court ordering’ is used in the contract governance literature. See Oliver E. Williamson, *The Economic Institutions Of Capitalism* (1985) at 5. Although not defined by Williamson in his book, court ordering in the context of contracting refers to the court system, procedural rules that determine the functioning of the court system and substantive rules that courts administer to resolve contract disputes. This is the general concept of law and the court system to resolve civil disputes

\textsuperscript{52} Stewart Macaulay, ‘Non-Contractual Relations in Business: A Preliminary Study’ (1963) 28(1) *American Sociological Review* 55

\textsuperscript{53} Ibid
performance of contracts.\textsuperscript{54} When disputes arose, bargaining to settle disputes usually took place within the framework of informal relationships rather than the court process, even if legal sanctions were available in the contract.\textsuperscript{55} However, the study also indicated that the non-contractual relationships vary from industry to industry and from relationship to relationship.\textsuperscript{56}

Stewart Macaulay’s 1963 empirical survey discredited the conventional assumption that contract law was the central institution of the market to support the process of contracting. He depicted contract law in practice that was very different from contract law in textbooks. According to a textbook view of contract law, business people enter into contracts ‘in the shadow of the law’, and the law gave business people ‘bargaining endowments’ to enable them to plan exchanges into the future, and to allocate risks, costs and benefits in the transaction.\textsuperscript{57} Macaulay’s inquiry into contract law in action suggested the opposite. In real life business, it seems that contracts have very little thing to do with the law and business people mainly rely on relationships to

\textsuperscript{54} Ibid

\textsuperscript{55} Ibid at 60-61

\textsuperscript{56} Ibid

govern their daily contracts. The study also drew scholarly attention to the role of private ordering in the resolution of contract disputes.

Lawyers widely cited Macaulay’s 1963 survey in their arguments for a new way to understand contract law. However, Macaulay’s survey of contract law-in-action is, at most, proof of the use and non-use of contract law in the business context of Wisconsin, the United States. Macaulay himself cautioned contract law scholars that his empirical study is only ‘preliminary’ for a hypothesis on contract law-in-action. There are good reasons for this caution. More recent empirical studies on contract practice in other markets reveal that contract practice differs significantly in different markets and even across different business communities within one market. It follows that the contract practice that Macaulay observed in his survey of the business community in Wisconsin may not reflect contract practice of business people in other markets, say, for example, Vietnam or Australia.

Blegvad’s (1990) work on commercial relations and litigation in Denmark was a rare attempt to test Macaulay’s thesis of informal networks for the resolution of contract

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disputes in other legal environments.\textsuperscript{61} To further Macaulay’s theory, Blegvad
borrowed the social science conception of ‘thematization’ – the process by which
actors select a frame of reference for their communications – to analyze the role of
informal networks as substitutes for the court process for contract dispute resolution.
In her words:\textsuperscript{62}

Legal thematization implies that a dispute arising from the transaction would active the legal
system with its institutional resources and sanctions. A dispute arising from a transaction
thematized in economic terms, on the other hand, would activate economic reasoning and
involve use of resources which draw on economic power relations.

Blegvad’s central idea is that if a contract is thematized on legal rights, then when
disputes arise, formal rules of law would be used to resolve the disputes. On the other
hand, if a contract is not thematized on legal rights, then when disputes arise, private
ordering would be used to resolve disputes.

Blegvad’s conception of ‘legal thematization’ explains why there are business
communities that thrive without a legal framework for contracting - even if a legal
framework for contracting is available. Further, it can be inferred from Blegvad’s
legal thematization theory that disputants would either choose to resolve their disputes
by the court process, or by the use of informal networks, and not both.

\textsuperscript{61} Britt-Mari Blegvad, ‘Commercial Relations, Contracts, and Litigation in Denmark: A Discussion of
Macaulay's Theories’ (1990) 24(2) Law & Society Review 397. See also the 1985 Special Edition
Wisconsin Law Review to commemorate Macaulay’s 1963 article. This edition mainly focuses on the
aspect of relational contracts, not dispute resolution

\textsuperscript{62} Britt-Mari Blegvad, ibid at 399
6. **PRIVATE ORDERING**

The literature on private legal systems asks the question: what are the substitutes for the legal process in the market? Scholars of private legal systems argue that there are institutional substitutes for the legal process that merchants may use to maintain order in their communities, and to support exchange in their markets, in ignorance of the contract law system. They found such private legal systems in the diamond industry in New York, in the cotton industry in Memphis, among ranchers in Shasta County in California and among Chinese rubber dealers in Southeast Asian countries, to mention a few for examples.

The work of Lisa Bernstein, in my opinion, is representative of the private ordering literature. In her study of the diamond market in the United States, Bernstein suggests an ‘opting-out’ theory that merchants, seeking to safeguard their contracting, can set up enforcement mechanisms to enforce their private norms that work more

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effectively than court ordering for public norms. Consequently, they may ‘opt-out’ of public ordering.

Lisa Bernstein’s ‘opting-out’ theory is a frontal attack on court centrality in the resolution of contract disputes. Her empirical research on contract practice in the diamond industry in 1993, and her recent article on contract practice in the cotton industry in the United States form the basis of her ‘opting-out’ theory. Two research projects, based on interviews with merchants in the two different industries, show that some industries have their own institutions especially designed to support contracting. These institutions are designed to fit with special characteristics of the main products of the industry. As Bernstein observes in the cotton industry in Memphis, the United States:

[t]he cotton industry has almost entirely opted out of the public legal system, replacing it with one of the oldest and most complex systems of private commercial law. Most contracts for the purchase and sale of domestic cotton, between merchants or between merchants and mills, are neither consummated under the [law] nor interpreted and enforced in court when disputes arise. Rather, most such contracts are concluded under one of several privately drafted sets of contract default rules and are subject to arbitration in one of several merchant tribunals.

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70 Ibid
In essence, Bernstein’s ‘opting-out’ theory seems to support Blegvad’s hypothesis of legal thematization, which was discussed earlier.\(^7\) Both suggest that, in certain contexts, courts may not be the last resort to resolve disputes. However, this hypothesis needs further support. The institutional frameworks in which the studies were conducted are local, or even industry-specific. For this hypothesis to gain wider recognition, there needs to be more work to test the hypothesis in different markets, or a theory developed that can apply across institutional settings and jurisdictions.

7. **The Contribution of This Thesis to the Contract Law Literature**

Given so many different views about contract law, it is apparent that the relationship between contract law and real life contractual arrangements is not fully understood in the contract law scholarship. The normative view of contract law does not explain the true role of contract law in real life contractual arrangements. This is arguably because of a widely held view that a law is a command of the sovereign backed by a threat of a sanction.\(^2\) A command is conventionally understood as comprising of five elements: (1) an expressed will of the sovereign that the subject will behave in a certain way; (2) an intention of the sovereign to sanction disobedience; (3) power to sanction; and (4) expressed threat to sanction.\(^3\) But in modern contract law, it is usually the case that neither intention to sanction nor the power to sanction are fully

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vested in the state (exercised by the court), which is usually understood as the sovereign in a normative view. Intention to sanction and power to sanction are actually, or at least also, vested in contracting parties, who decide whether, when, and how to use the legal process. If the promisor breaches a principle of contract law and causes damages to the promisee, it is the promisee who decides whether to sanction the promisor or not by way of a legal process. Thus, contract law together with the court process is just one of several instrumental institutions, others being private ordering systems, to ensure the performance of contractual arrangements.

Also in that view, there is no guarantee that the contract law system as an instrument would always triumph over private ordering systems in ordering real life contractual arrangements in the market. Ultimately, what merchants want is not necessarily to use the state coercive power that features legal norms. What they want is an instrument that serves their purpose the best, namely, optimization of the efficiency of contractual arrangements. The choice between the law and private ordering systems may, therefore, depend on the nature of specific transactions and contexts.

The relational view of contract law may also mislead law students about the role of contract law in real life contractual arrangements. Relational contract theory and private ordering literature tend to completely ignore the role of contract law in real life contractual arrangements. Empirical studies can provide descriptive insight into contract practice in specific markets, but lack the normative insight. The fact is that in many markets contract law is still the key framework for contractual arrangements. Businesspeople still use lawyers in negotiating, drafting contracts and resolving contractual disputes. Contractual disputes still go to court. The relational approach has not so far been able to produce a theory about the true role of contract law.
This thesis contributes to the diverse literature on contract law theory. The theory of ‘bargaining in the shadow of the law’ has well served the study of resolution of private right disputes. But this theory ignores the shadow of informal institutions that may play a role as important as the court’s shadow in the resolution of contract disputes in Southeast Asian countries. My study modifies the theory of ‘bargaining in the shadow of the law’ by arguing that informal institutions also shape the bargaining process for resolving contract disputes in Vietnam at least, and possibly more widely in Southeast Asia.

The contract law-in-action hypothesis needs more empirical testing. As mentioned, Stewart Macaulay’s empirical study of the contract practice of businesspeople in Wisconsin, the United States, pioneered the contract law in practice literature.74 My research reveals that studies following Macaulay’s path have been carried out in only two other jurisdictions. One is on contract law in practice in the United Kingdom by Hugh Beale and Tony Dugdale in 1975.75 The other is also on contract law in practice, but in Denmark, by Britt-Mary Blegvad in 1990.76 Janet T. Landa also studied the contract practice of ethnic Chinese businesspeople in Singapore and Malaysia, but hers is an economic analysis of contract models.77 This thesis would


75 Hugh Beale and Tony Dugdale, ‘Contracts Between Businessmen: Planning And The Use Of Contractual Remedies’ (1975) 2 British Journal of Law and Society 45


contribute to the currently very limited understanding of contract law in practice in Vietnam and Southeast Asia.

Relational contract theory urges courts and contract law drafters to recognize relational factors of the whole contractual relation in resolving contract disputes. This theory fails, however, to identify relational factors in specific social settings. My study thus furthers relational contract theory by identifying specific relational factors in contract disputes in Vietnam.

The theory of bargaining in the shadow of the law and the economic analysis of legal dispute and their resolution assumes that court ordering is the only institution that forms the bargaining endowments in settlement of contract disputes. My study argues that bargaining endowments for contracting parties to negotiate to settle their contract disputes may come not only from the expected outcome of litigation, but also from the shadow of other informal institutions in the market.

A practical contribution of this thesis may be to contract law reform in Vietnam. How business people rely on the contract law system to organize their business transactions in the market depends largely on the availability of alternative ordering systems and how these alternative systems interact with the law. This thesis therefore also makes suggestions regarding contract law reform in Vietnam, particularly as to what Vietnamese law makers should do to create a contract law system that better supports contracting in the market.

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CHAPTER 3 – METHODOLOGY OF MY RESEARCH

This thesis is an interdisciplinary endeavor. It analyzes the functioning of the contract law system from outside, focusing on the interrelationship between the contract law system and informal social structures in the market. Studying contract law doctrine per se does not help to answer the thesis questions because, as Galanter put it:

[contract doctrine is like the baseball rulebook. It tells you what the players are supposed to do and how the umpires are supposed to rule, but you can’t envision the game by examining the rulebook alone.]

In addition, this thesis focuses on the influence of contract law reform on commercial contracting, which is, in nature, an economic process.

The methodology employed must therefore be capable of assisting an understanding of the interrelationship between the legal process and the economic process. Specifically, it must first assist in demonstrating the relational dimension of contract law and the institutional and social constructions of the corresponding relationships. Secondly, it must assist in understanding the relationship between the legal and the economic processes.

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1 Marc Galanter, 'Contract In Court; Or Almost Everything You May Or May Not Want To Know About Contract Litigation' (2001) Wisconsin Law Review 577 at 577

2 Transaction cost economists see contracting as a key institution of the market. See Oliver Williamson, The Economic Institutions Of Capitalism (1985) at 17
1. **INSTITUTIONAL LAW & ECONOMICS**

Institutional law and economics theory provides key conceptual premises to guide the investigation of the thesis questions. At the core of institutional law and economics are propositions of institutional theory, which has a sociological provenance, and which has served as a traditional research methodology in social sciences for centuries.\(^3\) The central tenet of institutionalism is that institutions matter in shaping social behaviors.\(^4\) Institutional theory gained promising applications in law and economics, when Ronald Coase introduced the concept of transaction costs.\(^5\) Coase argued that different institutional structures incur different transaction costs, therefore inducing economic actors (in this study largely contractors and merchants) to choose among different transactional arrangements to economize on the transaction cost of an institutional structure.\(^6\) Coase’s theory of transaction costs provided a framework by which different institutions can be analyzed for their efficiency. In addition, it is suggested that institutions can be modeled to shape economic behavior.

Drawing on the concept of transaction costs, Douglass North developed institutionalism into an operational model of institutional change and economic performance (popularly known as New Institutionalism), with a set of propositions

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5 As observed by Ellickson, the concept of transaction cost has become one of the most pervasive economic concepts in legal studies. Robert C. Ellickson, 'Trends in legal scholarship: a statistical study' (2000) 29(1) *Journal of Legal Studies* 517 at 526

that explain the interrelationship between institutional change and economic performance.\textsuperscript{7} The methodology developed out of the works of Coase and North has wide application in economics and has started to be adopted in law.\textsuperscript{8} This thesis draws upon the conceptual premises of the New Institutionalism as expounded in the works of North. It takes the view that institutions shape market behaviors. This view sheds light on the role of law and other social institutions in real life contractual arrangements in the Vietnamese market.

More particularly, institutionalists believe that there is a nexus between institutional change and economic behavior.\textsuperscript{9} Economic players respond to incentive structures embedded in the institutional framework in the way that optimizes their utility.\textsuperscript{10} If the institutional framework changes, then economic behavior may change accordingly in response to changes in incentive structures of the institutional framework.\textsuperscript{11}


\textsuperscript{8} For an introduction to the institutional approach to law and economics, see Steven G. Medema, Nicholas Mercuro and Warren J. Samuels, 'Institutional Law and Economics' in Boudewijn Bouckaert and Gerrit De Geest (eds), \textit{Encyclopedia of Law and Economics Volume I. The History and Methodology of Law and Economics} (1999). For various applications of the New Institutionalism in the study of legal and regulatory issues, see, for example, Margaret Oppenheimer and Nicholas Mercuro (eds), \textit{Law and Economics: Alternative Economic Approaches to Legal and Regulatory Issues} (2005)


\textsuperscript{10} Douglass C. North, ibid. Also Douglass C. North, Where Have We Been, And Where Are We Going? (1997) SSRN Electronic Paper Collection < http://ssrn.com/abstract=1494 > 2004

Contract behavior, as it is discussed in this thesis, is the way economic players (who would be legally defined as contractors) respond to incentive structures in the institutional framework of the market to realize economies of projecting exchange into the future. Given this nexus, studying contract behavior helps predict how contract law reform may influence or remain irrelevant to contract practice in the market.

Institutionalists also see the institutional framework as composed of multiple institutions. Institutions share a common structure, composed of norms and incentive structures that induce compliance with norms. There are formal institutions, that is, the law promulgated and enforced by the state; and informal institutions - that is, to use the words of Richard Posner, ‘rule that is neither promulgated by an official source, such as a court or a legislature, nor is enforced by the threat of legal sanctions, yet is regularly complied with’. This multiplicity of institutions creates complex incentive structures that shape economic behavior in the market. As this study will show, contract behavior may change in response to either contract law reform (formal institutional change) or changes in the informal social structures of the market or both.

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14 Ibid

Further, institutionalists posit that institutional change is incremental and path-dependent. North explained institutional change by his theory of ideologies. Ideologies are either conscious or unconscious theories that individuals develop to explain the world around them, including the institutional framework in which they live. Individuals develop their ideologies through education and experiences with external conditions. If external conditions change, then ideologies also change. But ideologies change at the pace of the learning curve, not at the pace of changes in external conditions. Individuals need time to accumulate experiences about external conditions and to process those experiences into theories that guide their conduct. This learning process makes institutional change incremental.

This theory of institutional change helps navigate the structures of the Vietnamese institutional framework. The multiplicity of institutions in the Vietnamese market makes it difficult to map out the institutional structures in the market. But tracing the path of institutional change in comparison with tracing changes in market behavior throughout a period of the history can tell us which institutional changes tend to induce changes in market behavior.

Although multiple institutions exist in the market, it is by analyzing the choice exercised by market actors that I can identify the dominant institutions that shape


18 Ibid at 49

19 Ibid at 53

20 Ibid at 53
contract behavior in the Vietnamese market. This thesis argues that because each institution is constituted by a set of norms and incentive structures to induce compliance with particular norms, different institutions tend to suggest different patterns of behavior in the same transactional situation in the market because norms differ. For example, religious norms and legal norms may suggest different patterns of behavior on the issues like abortion or homosexual marriage. Therefore, market players have to select among multiple institutions in the market, determining which institution is dominant and most influential upon contract behavior.

2. Surveys

As mentioned in Chapter 1, the first inquiry into the nexus between contract law reform and real life contractual arrangements in the Vietnamese market is to understand how local merchants contract and resolve their contractual disputes. My inquiry should be conducted by surveys of contract behavior. I employed a sociological approach in which law is considered a ‘social factor’ that is influenced by ‘the interactions, motivations and beliefs’ of the members in the society’. 21 There were several reasons for selecting such an approach. Firstly, an objective of this project was to gain an in-depth understanding of contract practices in Vietnam. A socio-legal perspective provides an effective means of explaining the institutional structures that give rise to the social phenomena studied. 22 Secondly, case studies can provide an enhanced understanding and explanatory insights into a particular inquiry.


22 Ibid
which in this case is the contract law-in-action hypothesis.\(^{23}\) Another strength of case studies is that they provide examples of ‘real people in real situations’.\(^{24}\) Undertaking investigation into the questions raised by this research through these means enables the exploration of the complex interactions of business norms, human relationships and the law in the particular context of contract governance. This enables an empirical picture to be formed of the role of contract law in real life contractual arrangements.\(^{25}\)

Interviews, observations and document analysis were my chosen instruments for data collection. In particular, face-to-face interviews, where the researcher played an active role in directing the line of inquiry provided in-depth information to answer the key research questions. Theoretical analysis was necessary to test results and for developing a deeper understanding of the relationships between the hypothetical and the enacted contract practices related by the participants.

**Overview of the sample**

Participants in the study operated in many different industries, but all had a history of at least four years in their current business at the time of the interview and therefore had accumulated experience in entering certain kinds of contracts in the area of their business. The majority of them were business-owners or the main shareholders in their businesses. All of them were at managerial levels of firms with full responsibility for contracting with their firm’s clients. The merchants surveyed were

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\(^{23}\) Earl Babbie, *The Practice of Social Research* (nineth ed, 2001)


categorized into four groups: Vietnamese merchants operating in Vietnam; ethnic Chinese merchants operating in Vietnam, Vietnamese merchants operating in Cambodia; and foreign merchants operating in Vietnam. There are several rationales for this categorization. Ho Chi Minh City was chosen as the place to conduct most interviews because the city is usually referred to as the most dynamic hub of the Vietnamese economy.\textsuperscript{26} Surveyed merchants in Ho Chi Minh City were exposed to complex transactional structures in manufacturing and service industries. Can Tho City, although not as dynamic an economic hub as Ho Chi Minh City, offered a traditional manufacturing and trading centre in the Mekong Delta and established business communities of Vietnamese and ethnic Chinese groups to study. Phnom Penh was selected as a comparative market place where the contract law system virtually does not exist.

The Ethnic Chinese merchants make up a surveyed group because they are usually described as loyal to their traditional business ethics and institutions.\textsuperscript{27} Ethnic Chinese merchants generally have strong reliance on their ethnic group in developing client bases, procuring credits, and resolving disputes. Strong family structure maintains their way of life, by upholding their traditional philosophies about life, business, and medicine. Surveyed merchants in this group were from the Shaozhu and Cantonese

\textsuperscript{26} See, for example, Martin Gainsborough, \textit{Changing Political Economy of Vietnam – The Case of Ho Chi Minh City} (2003)

\textsuperscript{27} See, for examples, Gordon Redding, \textit{The Spirit of Chinese Capitalism} (1990); Anthony Reid, \textit{Southeast Asia in the Age of Commerce 1450 - 1680, Volume Two: Expansion and Crisis} (1993)
language groups, which are the two most populous ethnic Chinese groups in Vietnam.²⁸

Vietnamese merchants doing business in Phnom Penh made up a surveyed group, as they virtually did business in a market without a contract law system by the time of the survey. Some of them are local traders of Vietnamese origin who have retail networks in Cambodia. Many still have relatives in Vietnam and travel back and forth between the two countries for holidays and businesses. Trade representatives of Vietnamese manufacturers in Cambodia are generally staff members of the firm assigned to act as the wholesaler of the company’s products within the Cambodian market. At some points during interviews, Vietnamese merchants doing business in Phnom Penh were asked to comment on their contract practice in Phnom Penh, compared with their contract practice back in Vietnam.

Three foreign merchants were selected as a comparative group to highlight differences between Vietnamese and other (Western) contract practice, anecdotally at least. One of these merchants came from Western Europe, the other two from Australia, where contract law systems are well developed compared with the contract law system in Vietnam. The merchants worked at managerial levels for transnational companies in Vietnam. Two of them set up their own businesses in Vietnam. All had worked or had been doing business in Vietnam for more than ten years. Most of their contracting was with local merchants. But before coming to Vietnam they received education and business training in Europe and Australia. They also had attained

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business experience in Europe or Australia before going to Vietnam. These backgrounds allow them to comment on contract practice in the Vietnamese market by comparing it with the contract practice they had experienced in Europe and Australia. They were interviewed in order to gain an ‘outsiders’ view’ of the characteristics of contract practice of local merchants.

**Interviews**

During 2003-2005, I conducted a survey of contract behavior in the Vietnamese market. I interviewed a sample of local and foreign merchants as outlined above in the Vietnamese market about how they contract and resolve their contractual disputes, and how they use the newly introduced contract law system.\(^{29}\)

The interviews in this study were conducted on the basis of a protocol. An interview pro-forma served as a guideline to establish the direction of the dialogue and assisted in ensuring the consistency and objectivity of the conduct of the interviews. The interviews were conducted in a conversational manner and care was also taken to undertake the interview as smoothly and naturally as possible, to reduce respondents’ inhibitions.\(^{30}\) Follow-up questions were posed on the basis of responses to previous questions, providing the flexibility and space for both the interviewer and the interviewee to discuss the questions and answers and to ensure effective communication. Some interviews lasted about 20 minutes. But most interviews lasted more than half an hour. Some interviewees were interested in the questions and were willing to explain more about their contractual arrangements. The focus of the

\(^{29}\) See Appendix

interviews was the contracting practice of local firms and possible influences on the structures of their business relationships, given the unattractiveness of the court process as a mechanism to resolve commercial disputes. The interviews sought to elicit the strategies used by merchants in their contract governance and the rationale for their use.

32 in-depth interviews were conducted with local merchants during my two field trips during 2003-2004. Single interview sessions were undertaken with each participating merchant and were conducted individually. The participants were introduced to me through some business networks that I have contact with, beginning with some of my friends who are now doing business in Ho Chi Minh City and Can Tho. I also approached persons not previously known to me at social gatherings of business people. Most local merchants I asked at business gatherings declined my invitation to take place in my research. However, some merchants of the younger generation who received education in Western countries were interested in my research and agreed to participate.

I was introduced to one foreign merchant in Ho Chi Minh City by one of my relatives of whom the foreign merchant was a business partner. Another foreign participant was introduced to me by my supervisor during the merchant’s short trip back home in Australia. That merchant then introduced me to another merchant in Melbourne. They met each other while doing business in Vietnam. All interviewees explicitly consented to be interviewed after I had explained to them the purpose of the interview. Most of the interviews were tape-recorded with the interviewees’ consent, but some participants refused to have their conversations recorded. These interviews were recorded exclusively in the form of field notes.
Data analysis

The purpose of data analysis was to further document local contract practice, and to confirm or question the validity and reliability of data obtained through personal communication in the interviews. The data analysis followed an institutional approach, which postulates that the structure of formal and informal institutions influence the way humans interact in efforts to maximize their wealth. Contracting is one key means of them doing so. Contract law and the court process to enforce contracts constitute the formal institutions for undertaking contracting. Contract law and the court processes influence contract practice especially in terms of transaction costs with the court process operating as a legal institution designed to reduce the transaction costs of enforcing contracts. This institutional approach assumes that merchants respond to legal institutions of the market in ways that maximizes their self-interest. In doing so, merchants design their contractual relationship in the way that maximizes their expected value from the transaction. In this sense, relational contracting is a practice that arguably maximizes the expected value of a business transaction by minimizing the transaction costs of the market.

The data from interviews covered a wide range of contract types including:

- Material supply contracts between manufacturers and material suppliers to plan input for production.


33 Merchants 1,6,7,8,10
• Distributorship contracts between manufacturers and wholesalers to plan production output and financial issues.\textsuperscript{34}

• Service contracts between service providers and service users to provide a one-off job, or an on-going consulting service.\textsuperscript{35}

• Sale of real estate contracts between real estate investors and households.\textsuperscript{36}

• Agricultural contracts between fertilizer, insecticide, and agricultural machinery traders and farmers, which usually require the trader to sell fertilizers, insecticides and other agricultural machineries to farmers on credit. Payments are usually collected by the end of the harvest, sometimes in the products harvested.\textsuperscript{37}

• Principle-agent contracts between principles and agents to perform a specific task, such as marketing a product.\textsuperscript{38}

• Trade agency contracts between wholesalers and retailers to plan the supply of a product during a certain period.\textsuperscript{39}

Across the spectrum of relational contract theory, these contract types vary from one-off, discrete, impersonal contracts to those heavily reliant upon a relationship

\textsuperscript{34} Merchants 1,8,10

\textsuperscript{35} Merchants 2,4,16

\textsuperscript{36} Merchant 8

\textsuperscript{37} Merchants 6,9

\textsuperscript{38} Merchants 2,4

\textsuperscript{39} Merchants 9,10,11,12,13,14,15
According to my observation and interviews with local merchants in the Vietnamese market, sale of real estate contracts are usually negotiated between strangers. A buyer reads the classified offer of the house in a newspaper, calls the seller for an appointment to inspect the house and negotiates the price. If agreement is struck, full payment is usually made in a few weeks. The buyer and the seller do not rely upon either past or future relations once the consideration is paid in full. Hence, contracts for sale of real estate commonly take the form of discrete contracts.

Distributorship contracts and agricultural contracts are usually reliant upon past and future relations between the contractors. A manufacturer usually tests a wholesaler’s sales volume and credit worthiness over a period of time before entering a distributorship contract, as the whole production chain may be geared to, or dependent upon, the wholesaler’s sale volume. In addition, the manufacturer may need to extend extensive credit to the wholesaler for marketing and promotion of a new product. There may be also arrangements on after-sale services that require on-going cooperation between the manufacturer and the wholesaler.

In agricultural contracts, the trader usually sells fertilizer, insecticide, and agricultural machinery to farmers on credit. The ability to collect debts from farmers depends very much upon the on-going cooperation between the trader and the farmer throughout the season which may be influenced by unpredictable variables such as changes in the weather which may require on-time supply of additional fertilizer or insecticide to rescue the harvest. In the event of poor harvest, the ability of the trader to call-in debts

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depends upon an on-going relationship with the farmer, whereby credit is extended during lean periods and recouped during bountiful seasons.

Such a wide range of contract practices enables examination of the roles of relational institutions and the contract law system in different contexts of exchange, operating under differing levels of uncertainty.

3. COMPARATIVE USE OF ANOTHER SURVEY

There exists another survey of contractual relationships in the Vietnamese market conducted by McMillan and Woodruff during 1995-1997. At that time, Vietnam was in the early phrase of transition from a command economy to a socialist-oriented market economy. As McMillan and Woodruff observed, there was virtually no contract law system that business people could rely on to enforce promises.41 Surveying privately owned manufacturing firms in Ha Noi and Ho Chi Minh City about how they enforce contracts, McMillan and Woodruff found that ‘Vietnam’s firms contract without the shadow of the law and only partly in the shadow of the future’.42 Despite recognizing that repeated-game incentives only partly help Vietnamese firms to enforce contracts, McMillan and Woodruff failed to explain the role of social structures of the market in what they described as ‘more elaborated governance structures’ of contractual arrangements in the Vietnamese market.43


42 Ibid at 652

43 Ibid at 638
The comparative analysis of contract behavior afforded by McMillan and Woodruff and my later study suggests that contractual arrangements in the Vietnamese market are characterized by relational contract behavior. But contrary to conventional assumptions, relational contract behavior in the Vietnamese market does not strictly follow the standard repeated-game hypothesis. In fact, real life ‘contracts’ in the Vietnamese market feature business and personal relationships that are interwoven, rather than pure commercial deals. As a consequence, local merchants tend to adopt relational contracting norms that aim to achieve overall efficiency of interwoven relationships rather than commercial one-off deals. This comparative analysis enables discussion about whether contract law reform influences contract practice or whether the pre-existing contract law system is the dominant institution that orders market transactions in the Vietnamese market.
CHAPTER 4 – CONTRACTUAL ARRANGEMENTS IN THE VIETNAMESE MARKET: TWO SURVEYS

Since the early of the Twentieth Century, legal realists have questioned whether contract law is more powerful than social norms in regulating contracts. More recently, challenges to the relevance of contract law to real-life contracts have been increasing in number, and have emanated from a wider base of literature that now includes contract law in action, relational contract theory, and law and economics analysis of contract law. In 1974, Grant Gilmore, a Yale law professor of contract, published a book in which he declared the death of what is now called classical contract law. Although contract law continues to be a core subject for undergraduate law students in law schools, contract law scholars have not provided satisfactory explanations for the theoretical foundations of contract law.

This chapter discusses my survey of real-life contractual arrangements in the Vietnamese market. It suggests the dominant influence of informal institutions rather than the formal law on contractual arrangements in this market. It helps to answer the thesis questions by providing empirical evidence of how local merchants in the


Vietnamese market select among institutional structures in the market to support their contractual arrangements.

Further, to map out dominant patterns of contractual arrangements in the Vietnamese market, this chapter analyzes how real-life contractual arrangements in this market respond to the new contract law system modeled after contract laws of developed market economies. Drawn from two surveys of contract practice in the Vietnamese market, one by McMillan and Woodruff in 1995-1997, the other by myself during my field trips in 2003-2004, I argue in the final part of the chapter that the governance structures of real-life contractual arrangements in the Vietnamese market is very much determined by institutional structures of the market. As a kind of social behavior, contract behavior can be shaped by social institutions in the market as much as, if not more than, contract law and the court system. This study confirms the contract-law-in-action hypothesis, but amends this hypothesis to stress the role of social structures of the market in shaping contract behavior.

My empirical study provides a test for the contract law-in-action hypothesis in the Vietnamese market. The implication of my empirical study is, however, not only limited to testing the hypothesis and providing another piece of market-specific empirical evidence to add to the existing sketchy picture of contract law-in-action preliminarily put forward by Macaulay four decades ago. In relation to legal reform in Vietnam, this study aims to deepen our understanding of how the recent introduction of a market-oriented contract law system in Vietnam functions in ‘real-life’ business after a long history of market suppression and distortion.
1. **MY SURVEY: AN INSTITUTIONAL VIEW OF RELATIONAL CONTRACTS**

In August 2004, Thai Vinh Truong, (the fabric tycoon of Soai Kinh Lam textile and fabric market in HCMC), disappeared, leaving behind debts from unexecuted contracts to the value of five million dollars. Most of these debts were advances from corporate and individual fabric wholesalers in Ho Chi Minh City to Kim Vien, (Truong’s company), for fabric shipment imports. According to local newspapers, most individual and corporate fabric wholesalers in Soai Kinh Lam market, (the largest wholesale market of fabric in Southern Vietnam), bought fabric from Kim Vien. Truong’s clients also included many big State-owned enterprises in the textile and fabric industry, who relied upon the tycoon for large volume and reliable supplies of fabric. According to newspaper reports, few of Truong’s clients had contracts in writing to prove their transactions with Kim Vien or their ownership of fabric left in Kim Vien’s warehouses, with the exception of some handwritten receipts issued by Truong’s two brothers who assisted Truong in the family business. Some buyers reported to the police that they had negotiated transactions valued up to a million U.S dollars on the telephone or orally during face-to-face meetings, evidenced only by some handwritten notes of money received.

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6 Phi Anh, 'Vụ trùm vải Thái Vinh Trương bỏ trốn: Nợ 21 tỷ đồng và gần nửa triệu USD! (The disappear of fabric tycoon Thai Vinh Truong: More than 21 billions VND and half a million of USD in debts!)', Pháp Luật (trans: The Law Newspaper) (Ho Chi Minh City), 13/9 2004,
Kim Vien is neither the first, nor probably the last case where local merchants relying upon relational institutions in the market to safeguard even high-value transactions, are exploited by rogue merchants. Similar cases include the Toan Gia Phuc and Ngoc Loan supermarkets in 1998 when the owners of these markets simply disappeared. These cases predictably shook local business communities and the lack of contractual evidence presented insurmountable obstacles for many creditors seeking remedies from the court. These cases reveal the risks attached to the common practice in Vietnam of undocumented relational contracting by the local business community which may exclude the safeguards afforded by the contract law and court systems. They also raise the questions of how local merchants enter and execute contractual arrangements in real-life business and what they do to secure these transactions.

2. WHAT DO ‘CONTRACTS’ MEAN TO LOCAL MERCHANTS?

The concept of a contract under the law contains four basic elements: an offer, an acceptance, an intention to create a binding agreement, and the payment of consideration. In textbooks, these concepts are commonly characterized in a more formal way: 'an agreement which is either enforced by law or recognized by law as affecting the legal rights or duties of the parties'. This legal conceptualization of ‘contracts’ suggests a formal structure of property rights and obligations, voluntarily created by contracting parties according to prescribed procedures, formalities and

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7 Kinh Doanh & Phap Luat (Business & Law) magazine, No. 43, 29/10/1998, at page 10

8 G.H. Treitel, An Outline of The Law of Contract (1979) 1
conditions to govern their exchange relations, and which is legally enforceable by the state under a more encompassing contract type – the social contract.\(^9\)

One key issue to be investigated by this research is the very real possibility that the concept of contract in real-life exchange relations in the Vietnamese market may not conform to this model. The research for this thesis undertaken in Vietnam indicated a common attitude among surveyed merchants that requesting a detailed evidenced contract reflected a lack of trust between business partners. When surveyed merchants were asked whether they used contracts for everyday business transactions, a common response was: ‘Well, here people usually don’t need contracts to do business’. The reason for this common attitude, as one merchant further explained, is that: ‘Trust is the most important. If you trust someone, you don’t need contracts to do business with that person’.\(^{10}\)

What can we conclude from this response? When merchants transact on the basis of trust, negotiating a contract becomes a redundant activity.\(^{11}\) Beyond this, negotiating a contract may even jeopardize business activity because many local merchants may refuse to do business with someone who insists upon formal contracting. A merchant

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\(^{10}\) Merchant 4

\(^{11}\) Oliver Williamson offered an explanation on this point: in the absence of opportunism, there is no need for contract enforcement, because whenever cooperation is efficient, parties will honestly cooperate and perform their parts to carry out the transaction and to split the profit fairly. Readjustment during contract performance is a matter of course to ensure efficiency of the transaction. When unexpected contingencies cause the transaction to be inefficient, parties would release themselves of the cooperation and honestly split the loss. In the absence of opportunism, there is no need to contract. Oliver E. Williamson, *The Economic Institutions Of Capitalism* (1985)
who runs a business consultant company in Ho Chi Minh City remarked: ‘Here people don’t like contracts. If you show them a carefully drafted contract, they may not do business with you’. This perspective strongly suggests that the creation of a structure of legal rights and obligations based on formal contracts is not a popular practice for contracting in this market.

During a lunch with a group of young entrepreneurs in Ho Chi Minh City, the researcher asked the CEO of a private telecommunications company whether he preferred formal contracting or trust-based business deals. The CEO, who had extensive business experience in multinational Western companies, responded that the choice between formal contracting and trust-based business dealing was one of his daily headaches. He related how among the staff of his company was a dynamic ethnic Chinese Vietnamese executive, who had created a number of key business opportunities for the firm, but who relied heavily upon personal relations to seek assurance for the firm's investments. These business opportunities arose largely through the executive's networks within the Chinese community, who are traditionally averse to formal contracting and enforcement procedures. The CEO faced a dilemma as to whether the company’s resources should be invested in trust-based business deals or whether to insist upon written formal contracts which would increase the CEO’s ability to manage the risks of non-performance but at the risk of upsetting the Chinese clients and potentially jeopardizing the deals. The CEO admitted that he

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12 Merchant 4

13 He had worked in the sale department of Nisso Iwai and Ericssons in Ho Chi Minh City for many years, then several years as a consultant to state-owned telecommunication giant in Ho Chi Minh City

14 Merchant 24
himself was more comfortable with the practice of written formal contracts, to which he had grown accustomed while working for multinational corporations. However, business for multinational corporations can be easily distinguished from local trade, as large transnational corporations often have the position and market power to demand their local clients follow their ways of contracting which fit within their organizational structures and transactional disciplines. The CEO further related that in running a private company that deals mainly with local businesses, it is difficult for him to reject the relational contract practice which is so dominant in the local market.\textsuperscript{15} As suggested in this entrepreneur’s story, relational business dealings therefore appear to be the mainstay of daily contracting between local merchants.

For those foreign to social norms that govern local contractual behaviors, local merchants may appear to be inefficient and overly casual in their contract practice. One common criticism of local merchants by Western merchants in Vietnam is that they operate as a ‘closed shop’, sometimes refusing to deal with a stranger despite the stranger offering a profitable business deal.\textsuperscript{16} ‘I met some local merchants who would clearly have a lot of benefit from doing business with us. But the way they behave makes us think that they want to chase us away’, a European furniture importer in Ho Chi Minh City complained.\textsuperscript{17} His comments highlight how local contracting practices have a tendency to prioritise the development of locally-based/familiar relationships even over profits, operating as a constraint upon the ‘free’ operation of the market.

\textsuperscript{15} Merchant 24

\textsuperscript{16} McMillan and Woodruff survey also noted this hesitance of local merchants to deal with strangers. See John McMillan and Christopher Woodruff, ‘Interim Relationships and Informal Credit in Vietnam’ (1999) 114 Quarterly Journal of Economics 12851315

\textsuperscript{17} Merchant 20
Looking more deeply into the rationale for prioritizing relationships in contracting, for many local merchants, the risks of doing business with a stranger, considered an unknown quantity, may outweigh the potential profits because they are not comfortable using formal institutions to support their contracts. A local manager said he would visit his customers to investigate not only their financial capacity, but also the personality of the customer.\(^\text{18}\) A pre-existing personal relationship makes visible the internalized norms or codes of conduct of the parties in their contractual behaviors facilitating planning and cooperation, making future exchanges between the two parties more predictable, and therefore more desirable. The potential to build a long-term relationship is considered a prerequisite for the bonds necessary to achieve good contracting behavior. Finite resources are concentrated upon building long-term relationships, commonly at the expense of short-lived business opportunities.

While Vietnamese merchants are generally averse to formal contracting, some surveyed merchants were aware of how they could use contract law and the enforcement mechanisms offered by courts as tactics in contract governance.\(^\text{19}\) Two surveyed merchants had actually lodged complaints with economic courts to pressure their clients to pay debts when negotiation processes had been exhausted. One was the head of the legal department of a large state-owned enterprise, the other the director of a door-to-door logistics company. It is interesting to note that in the second case, almost all clients of the logistics company were foreigners moving in and out of the country who needed the company’s services to move their belongings. Perhaps in this


\(^{19}\) Merchants 2, 5
market, an adversarial reputation may not be as negative for the company’s image as it is in a market where clients are local merchants.

The research undertaken indicated that ethnic Chinese merchants are more averse to formal contracting than their Vietnamese counterparts. All the ethnic Chinese merchants interviewed in Can Tho City and Ho Chi Minh City stated that they had never relied upon the court system, either to overcome negotiation impasses in contractual disputes, or to strengthen their bargaining position for enforcement of contracts. The key strategy utilized by ethnic Chinese merchants for minimizing the risk of contractual non-performance was insistence upon a deeper understanding, and approval, of the personality of the business partner.

A general conclusion that can be drawn from the survey of local merchants undertaken is that contracts are founded upon personal relationships of trust and harmony between the merchants. A contract does not have the meaning of a ‘sharp in, sharp out’ deal. Instead, it is embedded within social relationships built between family members, friends, or social networks.

As commented by the Australian entrepreneur, contracts in the Vietnamese market are ‘a very, very relational thing’. 20 He related that in Australia, contracting is usually an adversarial process where parties would try to get as much as possible out of the contract. Companies often have a contract administrator, who would study every clause of a contract and ensure that the contract is strictly adhered to. As a consequence in the Vietnamese market, the contracting process may include visits to workplaces, residential houses, or meetings on tennis courts, in restaurants and tea

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20 Merchant 33
houses for dinners, lunches, and drinks, during which contracting parties seek to learn about the personal norms of the other parties to help predict contractual behaviors and renegotiate contractual positions when the market changes. The conventional functions of contracts as planning tools to project exchange into the future, devices to allocate risks and costs, instruments to guarantee against non-performance fade in significance against the priority of developing business relationships supported by more holistic human relations.

The research undertaken supports the view that Vietnamese local merchants generally do not draft contracts for planning purposes. Those merchants who used written contracts described their contracts as brief and containing only general terms. Some who did write contracts said that they used a written contract to keep a record of what had been agreed to, rather than for the purpose of planning to achieve contractual efficiency. One participating merchant further explained that implicit in the relational norms practiced in this market was the notion that client relationships naturally evolve from good inter-personal relationships. Careful drafting of contracts to govern a business relationship may signal that the merchant does not value the relationship highly and that therefore there will be fewer opportunities for cooperation. An alternative perspective offered by some merchants was that the Vietnamese market was still unstable due to institutional reform, hence the best

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21 It is a common practice in the market that merchants visited their clients’ shops to learn about personality, work habits, and business acumen of their clients. John McMillan and Christopher Woodruff, 'Interim Relationships and Informal Credit in Vietnam' (1999) 114 Quarterly Journal of Economics 12851287

22 Merchants 3,4,5

23 Merchant 21
business strategy was to refrain from long-term contracting.\textsuperscript{24} Planning an exchange into the future is not as important as planting a good relationship which is a more secure way to ground future opportunities for profitable cooperation.

Those surveyed merchants who did write contracts generally viewed the dominant function of a contract as a mechanism for reducing disputes rather than a process for planning future exchanges. Again, those participant merchants described the verbal exchange of offer and acceptance done in the everyday course of their business less as a contracting issue than an issue of personal integrity, the need to save face or maintain \textit{chữ tín}, an essential norm of business transactions.\textsuperscript{25}

Given the superiority of relational institutions over contract law in managing the risk of local merchant contract practice, ‘contracting’ in this context may be better described as transactional governance, rather than contract governance. As put vividly by an European merchant who run a furniture business in Ho Chi Minh City, contracting in Vietnam can be featured as ‘Beer’ and ‘handshake’ contracts: European merchants work hard during the negotiation of the contract, then go out for dinner to celebrate the successful negotiation. Vietnamese merchants go out for dinner first, chat about personal things during the dinner, then negotiate the basic terms of the contract over a beer, and conclude the contract with a handshake in the office.\textsuperscript{26}

\begin{flushleft}
\textsuperscript{24} Merchant 3
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\textsuperscript{25} A simplified interpretation of \textit{chữ tín} is trust, but local merchants interpret \textit{chữ tín} as compliance with a moral code rather than simply keeping promises. Chapter 7 of this thesis discuss \textit{chữ tín} in more detail
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\textsuperscript{26} Merchant 20
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The next sections will look into more details of how surveyed merchants structure their contracts into relational institutions that support their business relationships.

3. **HOW DO LOCAL MERCHANTS NEGOTIATE THEIR ‘CONTRACTS’?**

The traditional wisdom of contract theories predicts that when contracting parties plan an exchange into the future, they extend resources to predict market contingencies, and ensure that contractual terms adequately cover their interests should those contingencies arise. The terms of the contract also structure the rights and obligations of the parties in the event of default and establish the mandatory rules if legal enforcement becomes necessary.

Contract law in Vietnam appears to loosen the role of legal frameworks for setting and enforcing norms to project exchange into the future. Most merchants interviewed did not have contract law in mind when they entered transactions. In Ho Chi Minh City where economic activities are most concentrated, contracts are normally entered into when a merchant picks up the telephone to call a friend to place an order, or to ask a friend out for a lunch, a dinner, or an occasional drink to place an order in more detail. Ex ante contracting – exchange of information, processing of information, bargaining on the allocation of benefits and costs – is usually a process that takes place during intervals in tennis match after office hours or during other social meetings, rather than in office with lawyers and secretaries assisting to pin down the terms. Usually, the relational norms that support the preceding and on-going

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27 Exceptions include merchants 2,3,4, and 23, who actually have law background

28 Merchants 2,4,9

29 Merchants 2,4,9,20,21
background relationship become implicit norms for the contract regarding risk-sharing and lineage of incentives.

Generally, surveyed Vietnamese merchants do not purposefully set norms in formal contracts with a view to later seeking reliance upon court orders for long-term exchange. Although the contract law system in Vietnam generally fails to enforce business contracts without written evidence of contracts, many interviewed merchants said that they usually did not write down their oral agreements. One surveyed merchant said he provided regular logistics services to a friend’s company without any evidence in writing about their transactions. Negotiations and renegotiations are memorized for the purpose of performance. Those who did not write down their oral agreements explained that they did not concern themselves very much with providing for uncalculated-for contingencies or the risks of their partners behaving opportunistically by breaching promises. They said they trusted their partners and believed that they could renegotiate with their partners for adjustments to contracts when regret contingencies arose. Despite the risk that courts may reject claims of contractual rights without evidence in writing to substantiate those claims, common practices which ignore any need for legal evidence to substantiate contractual claims suggest that merchants do not consider important the setting of norms through formal contracting or to seek court ordering assurance for their exchange.

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30 Ordinance on Economic Contracts, Article 1: ‘Economic contracts are agreements in writing or exchange of documents…’. The Commercial Code 1997 left untouched this requirement on contract formality because Article 49 of this Code said that contracts required in writing by other laws (that is, the Ordinance on Economic Contracts) still need to be in writing

31 Merchant 27
Bargaining for contractual terms ‘in the shadow of contract law’ to secure access to legal remedies and sanctions is a common conventional contract law strategy to deter opportunism and to ensure contractual rights in the case of non-performance or if disputes arise. However, most surveyed merchants did not use this strategy. More than two-thirds of surveyed merchants reported that they never used written contracts in their business transactions. The other one third who reported the use of written contracts said they did not draft contracts with legal remedies and sanctions in mind and that they intentionally limited the use of written contracts, keeping terms to a minimum level to avoid ‘stiffening’ business relationships. Those who used some form of written contract were mostly firms based in Ho Chi Minh City where the market is much larger, transactions more complicated, alternative clients easier to find, and the court easier to access.

To contrast with Western contract practices, an European merchant in Ho Chi Minh City describes contract negotiation in the Vietnamese market as flexibility, renegotiation, and compromise: European merchants expect the contract to be executed according to a strict interpretation of the contract, word by word. Penalties are automatically applied when delivery is late, quality or quantity varied, or when there are minor breaches of contract. For example, when goods are delivered with some minor defects, the best that the seller can expect is a discounted payment into his/her account. Local merchants telephone their business partners to renegotiate the contract when contingencies arise. Contract terms and conditions are interpreted loosely, according to the underlying relationship. Compromise during renegotiation is expected and necessary for the survival of the underlying relationship going.32

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32 Merchant 20
4. How do local merchants monitor performance and enforce their ‘contract’?

The rationale underlying the theory of ‘repeated game’ suggests that the key sanction against reneging in relational contracting is the loss of future gains from trade if the partner quits the relationship in retaliation.\(^{33}\) Cooperation is stable if the discount rate is not too high, and if it is understood that retaliation will follow the tit-for-tat rule.\(^{34}\)

In the world of local merchants, renegotiation during the performance of a contract is not only an accepted practice, but sometimes a business morality. When asked how they would respond to a client who insisted upon revising the terms and conditions agreed to earlier in the transaction, most surveyed merchants said that they would agree to renegotiate with their clients.

Surveyed merchants indicated that it was not uncommon for trading partners to telephone them to report unexpected contingencies, and to suggest some changes to what had been negotiated.\(^{35}\) As some surveyed merchants explained to me, the norm in the market that shapes this practice generally indicates that if a client has difficulties living up to his/her obligations, the merchant should agree to renegotiate and should compromise if necessary to help the client, and maintain the merchant’s \textit{chữ tín} (prestige) in the market.\(^{36}\) ‘Keeping a good reputation is the most important


\(^{34}\) Robert Axelrod, \textit{The Evolution Of Co-operation with foreword by Richard Dawkins} (1990 ed, 1984)

\(^{35}\) All merchants agree that this is a received practice. Particularly, merchants 10,15,17,21 stressed that they followed this practice in their daily business contracting.

\(^{36}\) Merchants 10,15
thing’, noted one local merchant; ‘in Vietnam if you treat customers fairly when they have difficulties you will have that reputation. People will do business with you because they think you will not kill them when they have difficulties’. This norm is particularly appealing when there is a pre-existing relationship between the merchant and his/her client. This practice is commonly applied by family businesses as a way to reward loyal clients, and to secure their future loyalty in the market. Some merchants who practice Buddhism quoted the Buddhist concept of the impermanence of life and of possession to explain why they think it is necessary to accept renegotiation and compromise during contract execution if their clients face hardship reflecting a much more flexible and forgiving framework than under conventional contract doctrine.

Contract law is rarely used as a basis for resisting renegotiation requests. A merchant in the garment industry, who engaged local contractors to supply products that he sold to foreign buyers, said he very often acceded to his contractors’ requests to renegotiate a deal, although for him it was very difficult to renegotiate with foreign buyers, leaving him vulnerable to breach of contract with his foreign clients. Despite the difficulty it placed him in, he stated that he had never used contract law as the basis for resisting requests for renegotiation by local contractors even though he was entitled to according to contract law standard. He explained: ‘What can I do? If I don’t agree [to renegotiate], they would say ‘O.K, if you don’t like, you can take your materials back’. It is difficult for me to find another contractor, and we don’t do one


38 Merchant 20
deal only, we still have to work with them in the future’. 39 Local merchants often try to keep the relationship going despite non-performance or deficiencies in performance. Disputes are generally resolved by amicable negotiation and within a framework which places a high premium upon maintaining relationships wherever possible.40

Surveyed merchants were also reluctant to threaten the court action to break negotiation impasses or to push for remedies. Local merchants expressed the common concern that suing trading partners may give them a bad reputation in the market as a person who is difficult to deal with.41 Non-performance of a contract is not sufficient in the eyes of other traders to justify the use or threat of court action against a merchant. It must also be clear to the merchant’s other customers or potential customers that the reneging partner cheated or behaved dishonestly.

In line with these sentiments, litigation or threat of litigation is not a common end-game strategy for contract disputes either.42 Even a director of a consulting firm in Ho Chi Minh City, who had an MBA from a European institution and a law degree from Ho Chi Minh City law school, said that he never mentions courts and contract laws with his clients when he tries to recover overdue debts.43 Most of his clients were

39 Merchant 17


41 Merchant 28


43 Merchant 4
from Asian countries such as Indonesia, Malaysia, Singapore, Japan and Hong Kong, usually with ethnic Chinese backgrounds, (except for some Japanese clients). To explain their attitudes towards contract law and court processes, local merchants usually quote the Vietnamese proverb: vô phúc dao tung dinh (To be involved in court is a misfortune).44

All surveyed merchants answered negatively to a question asking whether using legal sanctions in carefully drafted contracts to induce compliance with the norms of their exchange is good for business.45 Not only is litigation not favored, but rights-based adversarial solutions to enforce contracts are seen as ‘selfish’ and generally not considered desirable. One surveyed merchant said ‘in order to keep long-term relationships with other customers, the firm must be very careful in dealing with disputes.’46

Among the thirty one local merchants interviewed, only one said that he sometimes mentioned courts and contract laws to overcome impasses during negotiations to resolve contractual disputes between his company and clients.47 He is the head of the legal department of a large state-owned company running a port in Ho Chi Minh City.48 Given his position as an in-house counsel of the company, it is clearly his duty

44 Merchant 5
45 Merchants 4,5,21
47 This ratio excludes merchant 23, who is a managing lawyer of a large lawfirm in Ho Chi Minh City.
48 Merchant 4
as well as personal interest to further legal solutions to commercial disputes. However, as he also explained to me during the interview, managers of state-owned companies sometimes choose to follow the legal process to avoid personal responsibility. When a transaction turns out to be inefficient, having a court decision that their contracting partner is responsible for the inefficiency of the transaction can help them to clear their responsibility for the transaction and to maintain their positions in the company.

The distinctiveness of contractual practice of local merchants has been noted by foreign merchants doing business in Vietnam, particularly those from Western-trained contract backgrounds. A surveyed European merchant who had lived in Vietnam for nearly a decade, when asked to compare contract dispute resolution practice in Vietnam with contract practice in Europe, characterized this practice as the ‘beautiful face’ relationship: Even when the deal goes sour because of impasses in renegotiation, Vietnamese merchants try to maintain friendliness and civility. Business disputes should not deteriorate into expressions of anger between the parties. Where they do, the impact is usually irreversible and a good indication that the relationship will terminate. These behavioral patterns, although unlikely to be universal in contract practice of all local merchants in Vietnam, suggest that there are, nevertheless, distinctive features of contract practice in Vietnam.

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49 Merchant 4

50 Merchant 20
5. McMillan and Woodruff’s Survey: A Standard Repeated-Game View of Relational Contracts

For the purpose of mapping contractual behavior in Vietnam, it is necessary to introduce the work of McMillan and Woodruff. They surveyed trading relationships in Vietnam during 1995-97 and provide an additional source of empirical data for my analysis of relational contracting in Vietnam. These two economists, McMillan of Stanford Business School, and Woodruff of the University of California, conducted a survey of 259 private firms in Hanoi and Ho Chi Minh City. They asked local merchants how they developed and maintained trading relationships in the absence of legal enforcement of contracts. They assumed that the incentive structures of repeated dealings between local merchants played the main role in inducing cooperation in contracting in the market. They explained this ordering mechanism as an *ad hoc* strategy, devised to compensate for the absence of a contract law system to enforce contracts in Vietnam. With data from the survey, they ran a regression with variables borrowed from the repeated-game theory exploring economic factors that determine the success of trading relationships in Vietnam market. Two key conclusions were drawn: First, that trading relationships in Vietnam fit into the standard repeated-game theory of relational contracts pattern; and second, that local merchants did not contract and resolve contract disputes in ‘the shadow of the law’.

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52 Ibid

53 Ibid
McMillan and Woodruff’s survey offers a rich empirical source for the study of contractual behaviors in Vietnam. However, nearly a decade has elapsed since their fieldwork. As a result of economic and legal reform, the context in which McMillan and Woodruff conducted their survey has changed significantly. Arguably, the market frictions that McMillan and Woodruff identified as key shapers of local contract practice have also changed significantly. During McMillan and Woodruff’s survey, the private sector in Vietnam had virtually no access to the court system to enforce contracts because the Economic Court was in a nascent stage, having been established only one year earlier in 1994. In addition to the weak court system, government policies at that time were not favorable to the private sector.

The Nobel Laureate economist Joseph E. Stiglitz recently observed how during the last decade, Vietnam has dramatically transformed its economy into a market economy at a pace that ranks it among the two most successful transitional economies in the world, the other being China. Given the rate and exchange within the


55 Chapter 5 discusses in more details formal contract law reform in Vietnam since McMillan and Woodruff’s survey in 1995-7 until my survey in 2003-4


57 Ibid at 1285

58 Joseph Stiglitz, 'Ethics, market and government failure, and globalization' (Paper presented at the The Vatican Conference at the Ninth Plenary Session of the Pontifical Academy of Social Sciences, Casina Pio IV, 2-6 May 2003)
Vietnamese economy, the business environment and market frictions that shaped contract practice in the 1990’s cannot be assumed to be the same as today. This then raises further questions as to whether and if so how contractual behaviors in Vietnam adapt and respond to the changing business environment.

6. A CRITIQUE ON THE REPEATED-GAME HYPOTHESIS OF RELATIONAL CONTRACTS

As noted, contract practice in Vietnam challenges the traditional view of contract law. In Vietnam, contractual relationships are not characterized by clear terms for a deal. Local merchants expect contract terms to be interpreted flexibly as the market unfolds during contract performance and do not expect themselves or their business partners to abide strictly by the terms. They tolerate demands for renegotiation of contractual terms during contract performance stage. They avoid adversarial mechanisms to resolve disputes. They avoid threatening sanctions for breach of contract in order to maintain the higher value of a cooperative image in the market. They prefer to negotiate amicably when a partner fails to perform their part of a deal. And they avoid making the opponent ‘lose face’. Local merchants neither contract ‘in the shadow of the law’, nor use litigation as the usual endgame strategy to seek remedies for their losses when bargaining fails.\(^{59}\) Thus far, my survey confirms some key findings about relational contract practices in the Vietnamese market of McMillan and Woodruff.

\(^{59}\) John McMillan and Christopher Woodruff, ‘Dispute Prevention Without Courts in Vietnam’ (1999) 15(3) *Journal of Law, Economics, and Organization* 637 at 637 (‘Vietnam’s firms contract without the shadow of the law and only partly in the shadow of the future. Although contracting rests in part on the threat of loss of future business, firms often are willing to renegotiate following a breach, so the retaliation is not as forceful as in the standard repeated-game theory and not as effective a sanction. To ensure agreements are kept, firms rely on other devices to supplement repeated-game incentives. Firms
The theory of ‘repeated-games’ explains an incentive structure of relational contracting. In this view, relational contracting is a governance structure that punishes breach of contract by the loss of future deals. Where relational contracting works smoothly to deter opportunism, that is, where the loss of future deals outweighs the benefit of opportunistic breach of contract, merchants may have no need for a contract law system.

However, the ‘repeated-games’ hypothesis of relational contracting does not fully explain contractual behavior in Vietnam. Whether through formal contracting or relational contracting, in order to sanction a breach of contract, one first needs to know whether a breach has occurred. How does one identify a breach if there was never a clear agreement of contractual terms? And how can breaches be sanctioned if one does not expect one’s partners to strictly abide to their commitments as the market unfolds? Moreover, the standard ‘repeated-game’ theory suggests that to induce cooperation, contracting parties necessarily follow a tit-for-tat strategy in response to contractual breach, which means that violation of contracts should instantly result in retaliation.  

In the Vietnamese market, my survey found, renegotiation of contracts is an accepted practice, and local merchants are reluctant to retaliate where contracts are breached.


61 For example, merchant 10 referred to Buddhist principles of tolerance when she was asked if she ever threatened retaliation against business partners who wrongly breached contracts with her company. See also John McMillan and Christopher Woodruff, ‘Dispute Prevention Without Courts in Vietnam’ (1999) 15(3) *Journal of Law, Economics, and Organization* 637
My survey also found that local merchants sometimes tolerated unreasonable demands for renegotiation of contracts, even where it exposed the victim merchant to the risk of breaching an inflexible contract with another party. These findings confirm a point not explained in McMillan and Woodruff’s study that in many aspects, the theory of repeated games is not reflected in real-life business contractual practice in Vietnam.

Some empirical studies in other markets suggest that merchants habitually follow the practices in these markets to conduct economic exchanges rather than wealth-maximizing norms for each and every transaction. Empiricists admit that economic variables do not always explain why contract practice differs in different markets.

Furthermore, economists have also observed that contract practices in the market do

62 For example, merchant 17 faced the risk of legal action from foreign buyers when his local contractors demanded to renegotiate contracts, but said that he did not intent to retaliate, in order to keep good ongoing relationships with them

63 John McMillan and Christopher Woodruff, 'Dispute Prevention Without Courts in Vietnam' (1999) 15(3) Journal of Law, Economics, and Organization 637 at 637 (‘Although contracting rests in part on the threat of loss of future business, firms often are willing to renegotiate following a breach, so the retaliation is not as forceful as in the standard repeated-game story and not as effective a sanction. To ensure agreements are kept, firms rely on other devices to supplement repeated game incentives. Firms scrutinize their trading partners. Community sanctions are occasionally invoked. Transactions with greater risk of reneging are supported by more elaborate governance structures’)

64 Stewart Macaulay, 'Non-Contractual Relations in Business: A Preliminary Study' (1963) 28(1) American Sociological Review 55

65 For an empirical study that reveals differences in contract practice in different markets, see Arne Bigsten et al., ‘Contract flexibility and conflict resolution: evidence from African manufacturing’, (Working paper, Centre for the studies of African economies, WPS/98-21, September 1998), available at <http://www.csae.ox.ac.uk/workingpapers/pdfs/9821text.pdf> (the authors admit that there are significant differences in contract practice across studied countries and sectors but these differences are not captured by economic variables of contract environment)
not always produce outcomes that achieve wealth-maximization. Hernando De Soto, for example, observed that in the informal business sector in Peru, merchants create and maintain trust, deal primarily with family members, and fashion long-term continuing relationships. These practices, which aimed at ensuring contractual performance, impose unnecessary transaction costs on the merchants, De Soto argued. In the realm of relational contracting, merchants may behave differently in different markets. McMillan and Woodruff perceived this when they decided to go to Vietnam to collect data in the field instead of relying on universal theories and American data. Why successful trading relationships in Vietnam have their own determinant factors that differ from successful trading relationships in other markets is a question that regression does not answer. It is here that my analysis differs from that of McMillan and Woodruff.

The answer, in my opinion, comes from what game theorists call ‘the nature’, and relational contract theorists call ‘the social matrix’. It is the matrix of social

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institutions in the market, not only legal but also informal institutions, which determine contract behavior. The institutional matrix influences contractual behaviors in the market by setting the preferences of the players, inducing them to adopt a strategy that may be not optimal for the player in a specific deal, but is considered optimal for the players in their overall performance within the market. As Douglass North put it, ‘only under the conditions of costless bargaining will the actors reach the solution that maximizes aggregate income regardless of the institutional arrangement. When it is costly to transact, institutions matter. And it is costly to transact’.  

Vietnam is a developing market. Transaction costs in developing markets are usually high because these markets are usually not yet well-structured, or they may lack conventional institutions to support transactions. Institutions therefore take on heightened importance in the study of contract practice in Vietnam. And the features of local institutions are critical in understanding the features of local contract practice. To overlook the characteristics of local institutions would lead to the misleading assumption that there exists a universal model of relational contracting.

Relational contracting in Vietnam is best described as a web of business transactions and non-business relationships that are interwoven into an on-going relationship. As this research has demonstrated, it is difficult to separate business deals from non-business deals in relational contracts in Vietnam. Local merchants in their pursuit of economic ends invest resources not only in negotiating, monitoring and enforcing business deals but also in numerous relational commitments in the social realm which

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are considered part of the business relationship. The relational contract depicted in this research is therefore not merely about the establishment of repeated business transactions with an implicit norm for re-adjustment, but interwoven multi-faceted relationships that support a business deal. Accordingly, an optimal governance structure of contracting in the Vietnamese market aims not only to achieve the economic ends of a profitable one-off transaction, but also efficiency and overall improved performance of the merchant in the web of relationships.

In game theory jargon, the preferences of players in games reflect the social norms in the market, and a study of the function of a contract law system cannot ignore the role of powerful social norms. Legal realists have long warned us of powerful social norms that compete with contract law as the rule of the game for contracting.72 The role of powerful social norms may also be used to explain some inconsistencies between the repeated-game hypothesis of relational contracting, and real relational contracting in Vietnam. My hypothesis here is that contract practice in Vietnam not only responds to incentive structures of the standard repeated-game theory, but also to the social matrix in which parties contract. A distinctive feature of contract practice in Vietnam is the outcome of a complex process of interaction between merchants – the players in the market – and the institutional framework in the market. Ideally, relational contracting in Vietnam should be explained using an institutional approach, which takes into account the existence of other social institutions in the market beside the contract law system.

Following the institutional approach, relational contracting in Vietnam market should be studied not only in the light of the repeated-game scenario of contracting in the absence of legal institutions, but also in light of the interaction between court ordering and other social institutions in Vietnam. This raises the question of what institutional structures induce the behavioral patterns of relational contracting in the Vietnamese market? And how do these structures emerge? These questions will be dealt with in the following chapters of this thesis.
MARX AND THE MARKET IN CONTRACT LAW

REFORM IN VIETNAM

Until very recently, commercial law reform in Vietnam still stirs up criticism from legal observers. [I am rewriting the introduction of this article]

In this article, I argue that the problem of contract law reform in Vietnam is two-pronged: old laws of the pre-Doi Moi era constrain free market exchanges, but new laws borrowed from Western markets largely fail to support relational contract practice in the Vietnamese market. The current contract law system features economic transition from a command economy of pre-Doi Moi era to a market economy, with the old contract law of pre-Doi Moi era co-functioning with new contract law borrowed from developed market economies more recently. The old contract law of the pre-Doi Moi era was inspired by Marx’s economics, which do not support free market exchange. This law restricts freedom of contract to enable state economic management, therefore failing to support efficient contracting that is mainly achieved by free bargaining in the market. New contract law doctrines were not adapted to respond to relational contract practice in the market, therefore largely failing to support the relational governance structure of market transactions.

Regarding the structure of this article, I first attempt to construct a threshold conceptual model of a contract law system and examine how it functions to solve the problems of contracting. This model is the working premise for my analysis of the functioning problems of the contract law system in Vietnam and suggestions for reform. Next, I examine the Vietnamese contract law system to see how it helps local merchants solve the problems of contracting in the context of a transitional market
economy in Vietnam and given the relational contract practice of local merchants. Finally, I conclude with some suggestions for contract law reform in Vietnam in relation to local relational contract practice.

1. THE EFFICACY OF A CONTRACT LAW SYSTEM

The contract law literature continues the search for a general contract law theory – which may help us to understand how an ideal contract law would operate – continues.¹ Clearly, the world’s legal systems do not function as a unified contract law system. Existing contract law models may be desirable for some markets, but not for others. That is why we can still distinguish between common law and civil law contract laws. To deal with this obstacle, I describe a contract law system as the ‘rules of the game’ for market exchange. The concept of the law as ‘rules of the game’ for market transactions was championed by Douglass C. North, who, as noted, succinctly pointed out how social institutions facilitate economic development in his book *Institutions, Institutional Change and Economic Performance*, for which he won the Nobel Prize.² As ‘rules of the game’ for merchants to project exchange into the future, the contract law system therefore should be designed to help merchants solve the problems of contracting to achieve their contracting purposes.

This working model of a contract law system helps me to evaluate the formal contract law system in Vietnam. The efficacy of the formal contract law system in Vietnam can therefore be analyzed on two grounds: i) whether it aims to help contracting


parties to achieve their contracting purposes (that is, in the context of this thesis, to maximize economic gains); and ii) how effective it is in doing so.

I start from the conception of a contract law system as an institution designed to support exchange in the form of contracting. In the positive theory of law, the law is a set of 'orders backed by threats', made by a sovereign who does not habitually obey anyone else’s orders and whose orders the great majority of the population habitually obey. Legal positivists classified the law into two categories of rules: mandatory rules and power-conferring rules. Mandatory rules require people to behave in certain ways whether they wish to or not. For example, tax law requires people to pay tax to the state - which many people may not wish to do - or face punishment. Power-conferring rules prescribe the procedures, formalities, and conditions for people to give effect to their wishes. Contract law falls into the second category.

The original purpose of contract law, as a set of power-conferring rules, is to confer upon parties an instrumental power to enforce their wishes in the form of a contract. By electing the coercive framework of contract law, parties voluntarily create ‘structures of rights and duties’ which typify their relation under law. Unlike mandatory rules, contract law is coercive on contracting parties only if they wish so...

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3 Hart, HLA, *The Concept of Law* (1961) at 37

4 Ibid at 49

5 Ibid at 28

6 Ibid at 28

7 Ibid at 94
and if they follow the prescribed procedures, formalities, and conditions.\(^8\)

Nevertheless, the ‘structures of rights and duties’ voluntarily created by contractual parties do not exclude them from obligations imposed by mandatory rules whether they wish or not.\(^9\) In effect, these mandatory rules may override or modify the ‘structures of rights and duties’ between contracting parties, despite their wishes regarding the relationship. Examples can be found in the area of consumer protection law, where consumer protection rules may override contract clauses that cause detriment to a party in the contract who is ‘consumer’ as defined by the law. The law that determines the ‘structure of rights and duties’ between contracting parties therefore comprises not only power-conferring rules that prescribe the procedures, formalities, and conditions for contracting, but also mandatory rules that override or modify the ‘structures of rights and duties’ between contracting parties. In general, the law as ‘orders backed by threats’ implies that both ‘order’ and ‘threat’ are indispensable parts of a law. Therefore, the institutional structure of a contract law system comprises both law and enforcement mechanisms.

I discuss how a contract law system supports contracting in the market by examining the system against its functioning tasks. The law, as a kind of social institution, provides ‘rules of the game’ for human interaction.\(^10\) Contracting in the market is a

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\(^8\) Ibid at 37

\(^9\) See, for example, Hugh Collins, *The law of contract* (1997) at 37, 46 (analysing *Carlill v Carbolic Smokeball Company* (1893) 1 QB 256, arguing that when the court applied the tests of enforceability to find a contract between involved parties, the court was imposing the ‘contract’ in the court’s view, not necessarily what parties intended)

form of human interaction, governed by the law of contracts.\textsuperscript{11} As ‘rules of the game’ for merchants by which merchants can contract, the overall institutional function of contract law is to spell out clearly what the norms are, so merchants can coordinate their expectation in their interaction to project exchange into the future. From this guiding function of the law, I argue that the general qualities of a contract law system are the transparency and intelligibility of rules.

The specific qualities of contract law derive from the nature of the specific kind of game that it supports, which is the game of contracting. Contracting, in its nature, is a coordination game in which parties project an exchange into the future.\textsuperscript{12} This coordination game faces two main problems that undermine cooperation and planning efforts.\textsuperscript{13} The first problem is incomplete contracting, which means that contracting parties cannot predict precisely how the market will change during \textit{ex post} contract performance, and how market changes will affect the efficiency of the transaction. This problem gives rise to re-negotiation opportunities during the life of the contract to rearrange the planning and cooperation between the contracting parties to optimize the use of their resources given changes in the market.

The second problem is opportunism, which means that market changes may give incentives for one party in the contract to behave opportunistically to externalize their regret costs caused by market changes to the other party, or to capture the other

\textsuperscript{11} On this point, see Max Weber, \textit{Basic Concepts In Sociology} (1962). Weber sees market relationships as a subcategory of social relationships

\textsuperscript{12} Macneil, Ian R., ‘Contracts: Adjustment of long-term economic relations under classical, neoclassical, and relational contract law’ (1978) 72 Northwestern University Law Review 854

\textsuperscript{13} Oliver E. Williamson, \textit{The Economic Institutions of Capitalism} (1985)
parties’ investments in the performance of their part in the contract. The fear of opportunistic behavior during contract performance deters attempts to enter a contract, unless the contract law system provides remedies sufficient to insure the risks of opportunistic behaviors, or sanction mechanisms to balance opportunistic incentives.\textsuperscript{14}

Given these two problems of contracting, the instrumentality of a contract law system depends on how efficient it is to solve the two problems of contracting. For example, contract law can help merchants to solve the problem of incomplete contracting by providing default rules that contracting parties can use to fill gaps in their incomplete contracts and therefore to reduce their bargaining costs. Or contract law can provide a promisee with remedies as a sort of insurance to cover reliance costs, and legal action as a sort of sanctions to deter opportunistic promisors.\textsuperscript{15}

In the market, economic players generally pursue economic efficiency. I measure the efficiency of contracting by the parameter of transaction costs.\textsuperscript{16} The overall purpose

\textsuperscript{14} In practice, contract law systems in general provide remedies for the wronged party by coercing a transfer from the wrongdoer. This mechanism achieves both the purposes discussed above at the same time: provide the promisee with insurance for the risks of opportunistic behaviours (remedy), and deter the promisor’s opportunistic incentives (sanction). My observation is that a functioning institution to support contracting does not necessarily provide insurance and deterrence at the same time. For example, market mechanisms that enforce promises using reputation sanctions deter opportunistic promisors without providing promisees with remedies. Nevertheless, the use of reputation sanctions to enforce promises is widely observed in many markets. See, for example David Charny, ‘Non-legal sanctions in commercial relationships’ (1990) 104(2) Harvard Law Review 373; Janet T. Landa, Trust, Ethnicity, and Identity (1994)

\textsuperscript{15} Posner argued that contract law provides insurance, not punishment against damages, see Posner, R., Economic Analysis of Law, (4 ed., 1992) 102

of contracting is to move resources to better uses. Accordingly, the less transaction costs in a contract law system, the more efficient the contract law system for merchants.

In the context of relational contract practice in the Vietnamese market, a relational contract is usually in the form of a business relationship of interwoven personal and business deals.\textsuperscript{17} Given this feature of relational contracts in Vietnam, economic efficiency of a relational contract is the aggregated efficiency of interwoven personal and business deals of the business relationship, rather than one-off deals. This depiction of the contract law system and contract practice in the market allows me to discuss the efficiency qualities of the three contract laws – the Ordinance on Economic Contracts, the Civil Code, and the Commercial Law – that make up the contract law system in Vietnam.

2. THE ORDINANCE ON ECONOMIC CONTRACT: GENESIS AND THEORETICAL FLAWS

‘History matters’, as North pointed out right in the beginning of his book *Institutions, Institutional Change and Economic Development*, because institutions evolve incrementally and borrow their characters from the past.\textsuperscript{18} To understand the contract law system in Vietnam now, one should examine how the system was built up within the context of legal reform and economic transition, from a planned economy before Renovation (*Doi Moi*) where there were no market and market institutions, to the

\textsuperscript{17} John McMillan and Christopher Woodruff, ‘Dispute Prevention Without Court in Vietnam’ (1999) *Journal of Law, Economics, and Organization* 637

current stage of economic transition toward a socialist-oriented market economy because the system borrows its main features from this context.\(^\text{19}\)

Of the current contract law system, the first contract law – the Ordinance on Economic Contracts – was introduced in 1989, three years after the Vietnam’s Communist Party officially embarked upon economic renovation (\textit{Doi Moi}). At that time, the economic system in Vietnam still operated like a mega-firm, owned and run by the state, where the government used administrative orders to allocate economic resources to state-run production units and a state-run distribution network would distribute the output to consumers.\(^\text{20}\) Arm’s length transactions among autonomous firms in the market, which, according to the bargain theory, move economic resources to better use, did not exist because private firms were either nationalized or collectivized during periods of hard socialist reform (\textit{cai tao xa hoi chu nghia}) and were re-organized by the state to function as production or distribution units of a centrally controlled economic system.\(^\text{21}\) In this economic system, transactions within

\textsuperscript{19} Le Dang Doanh, ‘Economic Reform in Vietnam: Social and Legal Aspects and Impacts' (1996) 6(2) \textit{Australian Journal of Corporate Law} 289


\textsuperscript{21} Contrary to the general thinking, the private sector in Vietnam mushroomed during the government of the Democratic Republic of Vietnam. In 1954, when the Democratic Republic of Vietnam took over Hanoi from defeated French administration, Hanoi had nine private industrial enterprises in electricity and water. During 1954-1957, when the government of the Democratic Republic of Vietnam pursued a pro-market economic policy to aid the recover of the economy from the war of resistance, the private sector boomed. In 1957, Hanoi had 1,055 private businesses (137 transportation companies, 497 manufacturing companies, 421 trading companies), and 18,000 small-size family businesses. But nationalization and collectivization from 1958 to 1960 transformed and reduced this private sector to 64 central-level manufacturing SOEs, 51 provincial manufacturing SOEs, 25 trading SOEs, 1,718 craft cooperatives, 25 transportation cooperatives, and more than 10,000 self-exchange cooperatives. See Vu Duy Thai, ‘50 nam kinh te tu nhan Ha Noi’ [trans: Fifty years of the private sector in Hanoi] (2004)
production and distribution units were to perform *chi tieu phap lenh*, or statutory assignments, which means orders of the government for the units to deliver specified outputs under periodical central economic plans.\(^{22}\) In a command economy, there was no need for contract law because there was no market, at least not in the official economic system.\(^{23}\)
Freedom of contract during early \textit{Doi-Moi}

The market first emerged in the agricultural sector during the early 1980s, when the drying up of support from the COMECON (the Council for Mutual Economic Assistance) and food crises led some provincial leaders to ‘break the fence’ (\textit{pha rao}) of central economic policies by de-collectivizing farmland.\textsuperscript{24} De-collectivization of farmland instantly increased agricultural output, because farmers could own what they produced.\textsuperscript{25} As farmers could produce more rice than their personal consumption while they needed other consumption products beside rice, they secretly exchanged paddy grain for other products, including agricultural machinery.\textsuperscript{26} ‘Black market’ for paddy grain and agricultural machinery mushroomed in agricultural provinces, despite the government’s bans.\textsuperscript{27} A ‘black market’ for the exchange of paddy grain and agricultural machinery further boosted agricultural production.\textsuperscript{28}

\textsuperscript{24} In January 1981, after two decades of food crisis as a result of compulsory collectivization of agricultural production, the Vietnam’s Communist Party’s General Secretariat issued Directive 100 CT to de-collectivize cooperatives’ farmland. This move quickly brought Vietnam back to the position of one of the three leading rice producers and exporters in the world. For a review of this change in Vietnam’s political economic policy see Quang Thiện, ‘Kỷ tích hạt lúa: đêm trước của khoán hộ (trans: The miracle of the paddy grain: the night before de-collectivization)’, \textit{Tuổi Trẻ} (Ho Chi Minh), 16/5/2005 <http://www.tuoitre.com.vn/Tianyon/Index.aspx?ArticleID=78687&ChannelID=11>

\textsuperscript{25} Xuân Trung and Quang Thiện, ‘Đêm trước’ đổi mới: cống phá ’lụy tre’ (trans: The night before Reform: bombard the ‘bamboo fence’), \textit{Tuổi Trẻ} (Hồ Chí Minh City), 4/12/2005

\textsuperscript{26} Ibid

\textsuperscript{27} Xuân Trung and Quang Thiện, ‘Đêm trước’ đổi mới: khi chớ trời bi đằng sấp (trans: The night before Reform: when the market was demolished), \textit{Tuổi Trẻ} (Hồ Chí Minh City), 2/12/2005

\textsuperscript{28} Xuân Trung and Quang Thiện, ‘Đêm trước’ đổi mới: cống phá ’lụy tre’ (trans: The night before Reform: bombard the ‘bamboo fence’), \textit{Tuổi Trẻ} (Hồ Chí Minh City), 4/12/2005
Lessons from the agricultural sector led the Communist Party to introduce the economic principles of Adam Smith into the Soviet-style command economy, to rescue an economic system in crisis, leading to further changes in economic management that culminated into the ‘Renovation’ (Doi Moi) officially launched by the Central Politbureau in 1986.\textsuperscript{29} From then, the whole economic system has gradually but firmly shifted, toward a market economy.\textsuperscript{30} Part of this process of economic renovation has been legal reform, which has been motivated by economic changes, but has become the institutional premise to stimulate further social and economic changes. Having learned from the collapse of the Soviet’s Perestroika, top Vietnamese political leaders cautiously took a step-by-step reform strategy, introducing new laws into the legal framework to facilitate new economic relations while continuing the effect of old laws to govern old economic relations.\textsuperscript{31} As a consequence, the legal reform process produced different ‘rules of the game’ for different types of players in the same economic playground. The same analysis applies to the contract law system in Vietnam, where old-style and new-style contract laws overlap and co-function as rules of the game for contracting in the market. The

\textsuperscript{29} Ibid
\textsuperscript{31} Le Dang Doanh, ‘Economic Reform in Vietnam: Social and Legal Aspects and Impacts’ (1996) 6(2) Australian Journal of Corporate Law 289 (‘At the same time [of economic reform], Vietnamese society is also being transformed into one based on the rule of law instead of being ruled by arbitrary directives issued by the authorities. Vietnam has chosen to do this one step at a time by implementing important laws instead of taking over an existing body of laws and regulations. The advantage of this approach is that laws are written to suit the unique conditions of the country. The obvious disadvantage is that such laws lack comprehensive and time-tested practicality which at times hinders their implementation and reduces their usefulness.’). See also Yeu, NV., ‘Orientations for perfection of the legal systems in the coming time’ (2004) 11 Vietnam Law and legal forum 2
first contract law in Vietnam after Doi Moi – the Ordinance on Economic Contracts – came out amid Vietnam’s ‘perestroika’.

**Marx’s economic theory of the Ordinance on Economic Contracts**

The theoretical background of the Ordinance on Economic Contracts was Marxist economic theory, which was, within the framework of the anti-market 1980 Constitution and the context of a planned economy, intended to be the interpretation theory for the law. Looking back, some Vietnamese law-makers trained in Soviet economics theories without being exposed to market economic theories still believe that the economic crisis during 1970s was the result of bad economic management, rather than the lack of market exchange in the economy.32

Law students in Vietnam learnt by heart the labor theory of value of Karl Marx’s political economy, which holds that the value of an exchangeable good or service lies in the amount of labor required to manufacture it, and the source of profits under capitalism is the surplus value of workers’ labor not paid out in wages.33 From a Marxist point of view, merchants join with capitalists who own means of production to appropriate the surplus value of workers’ labor. Marx's economics opposes Adam Smith’s theory of exchange, which holds that exchange generates value by moving resources to better use.34 At the height of hard socialist reform in Vietnam during

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33 Karl Marx, *A critique of political economy* (1944), volume 1 Workers/literature bureau

34 Adam Smith, *An enquiry into the nature and causes of the wealth of nations* (ed., 1976)
the state did not recognize the value-creating function of the market. Consequently, a planned economy was organized so that arm’s length exchanges between autonomous and independent firms were transformed into state-ordered transactions between state-controlled units of the economy. Freedom of contract was rejected to avoid the accumulation of private ownership of means of production, which, according to Marxist thinking, is the cause of class exploitation and social disruption.

The Ordinance on Economic Contracts was arguably the product of a Soviet-style economic system of central planning amid deep crisis in 1970s-80s, and of reactionary mentality about economic reform of the political elite that led to limited recognition of market exchange. The premise of the Ordinance on Economic Contracts was not market economic theories, but the ‘fence-breaking’ model of agricultural output contracts first experimented with in some Northern agricultural

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36 1980 Constitution, Article 18: ‘...the national economy consists of two sectors: the State-owned sector under the ownership of the entire people and the co-operative sector under the ownership of a collective of working people’

37 This thinking still lingers among the political elite, who were previously trained in soviet education and have not acquainted themselves with the theories of a market economy. See, for example, Nguyễn Thanh Tuyên, Nguyễn Quốc Tế and Lương Minh Cử (eds), Sở hữu tư nhân và kinh tế tư nhân trong nền kinh tế thị trường định hướng xã hội chủ nghĩa ở Việt Nam (Private Ownership And The Private Sector in the Socialist-Oriented Market Economy in Vietnam) (2003)
provinces in Vietnam to overcome food shortages due to low agricultural productivity.  

In the agricultural output contract model that the government experimented at that time, agricultural cooperatives leased pieces of collective land to farmers on a contractual basis and collected rent in paddy, leaving the surplus of the harvest in the farmer’s own disposal. This first step of economic reform, I would argue, when freedom of contract was first introduced into the obligatory producer-buyer relation between farmers and the state, was not an economic policy inspired by the efficiency of freedom of contract, but a spontaneous strategy of grassroots politicians to counterbalance productivity crisis by compromising to market forces. Agricultural production increased dramatically as farmers had incentive to produce greater harvest surplus. When the efficiency of the contract model was evident to the political elite, farmers were no longer obliged to sell their all harvest to the State at a low price fixed by the State.

See the series of chronicles by Xuân Trung and Quang Thiện on Tuổi Trẻ Newspaper during 30/11/2005 and 16/12/2005, particularly, Đăng Phong, "Đêm trước' đổi mới: từ chay gào đến phá cơ chế (trans: The night before Reform: from 'earn one's daily bread' to destroy the mechanism)', Tuổi Trẻ (Hồ Chí Minh), 7/12/2005; Xuân Trung and Quang Thiện, "Đêm trước' đổi mới: chuyễn đổi vô hình (trans: The night before Reform: invisible transformation)', Tuổi Trẻ (Hồ Chí Minh), 10/12/2005; Xuân Trung and Quang Thiện, "Đêm trước' đổi mới: công phá 'lũy tre' (trans: The night before Reform: bombard the 'bamboo fence')', Tuổi Trẻ (Hồ Chí Minh City), 4/12/2005


The 5th Congress of Vietnam Communist Party in 1986 decided ‘to abolish the centralized bureaucratic State subsidized regime, establish and create a complete planning mechanism in which planning is central, proper application of the cash-goods relation’.  

Decision 217 of the Council of Ministers allowed state-owned enterprises to choose the buyers for their products and to enter joint ventures and cooperation with other economic entities. The 6th Conference of the Central Party (6th tenure) in 1989 defined more specifically the ‘new economic management mechanism’ as a ‘planned socialist oriented multi-sector commodity economy’.

Some fundamentals of Adam Smith’s economic theory of exchange were introduced into the socialist economic system of central planning. It was amid this change in the economic management mentality of the political elite that the Ordinance on Economic Contracts was introduced.

The Ordinance was the first contract law in Vietnam since independence. Before the Ordinance, ‘contract law’ was in the form of administrative decrees issued by the government and its agencies to regulate obligatory transactions between state-owned and state-run units to implement periodical economic plans. The Ordinance was the first contract law that regulated economic activities between enterprises, including those between state-owned enterprises.

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43 My research on Lawdata, the legal database of the National Assembly, traces legislation on economic contracts to the foremost legislation on economic contracts, which is Decree 4-TTg dated 4/1/1960 of the Prime Minister to promulgate a provisional protocol on economic contracts. This first legislation on economic contracts was later replaced by Decree 54-CP dated 10/3/1975 of the Government to promulgate the protocol on economic contracts. Article 2 of Decree 54-CP wrote: ‘Entering economic contracts is a discipline of the State. In all economic activities with others, one
first ‘contract law’ in the sense that it was promulgated by a legislative body – the Council of the State, which was then the collective President of the state – not an executive body.\(^{44}\) Another advanced aspect of the Ordinance is that it limitedly recognized the freedom of contract for state-controlled economic actors.\(^{45}\) A series of other regulations followed the Ordinance that recognized limited commercial freedoms in the state-controlled economic system:

- Law on Maritime Transportation 1990 to regulate the market of maritime transportation,
- Law on Private Enterprises (comparable to single-shareowner proprietary companies) 1991 to recognize the right to incorporate of traditional family businesses,
- Law on Companies 1991 to recognize the right to incorporate of private economic actors in the form of limited companies, and joint-stock companies,
- Law on the Organization of People’s Courts 1991 to set up civil courts to hear civil disputes, among which many were small-scale commercial disputes traditionally resolved by relational institutions,\(^{46}\)

\(^{44}\) 1980 Constitution, article 98

\(^{45}\) Ordinance on Economic Contracts, Article 4: ‘Entering contracts is the right of economic units. State agencies, organizations, and individuals are not allowed to impose constraints on the autonomy of contracting parties.’

Law on Bankruptcy 1994, and
Law on the Organization of Courts (amendment) 1994 to introduce the specialist Economic Courts to hear commercial disputes.

Many other laws also followed, to constitute a framework for the market.47

I argue here that the Ordinance on Economic Contracts was not drafted to be a framework of power-conferring rules to support voluntarily structured exchange relations, but rather mandatory rules that require how an exchange relationship must be structured for the convenience of the State’s economic control and planning purposes.

First, the constitutional framework in which the law was enacted was the 1980 Constitution. Compared with the 1946 Constitution and the 1992 Constitution, 1980 Constitution was the most anti-free market exchange constitution because it was a copy of the hard socialist Soviet Constitution 1977.48 The constitution stated that the State would eradicate free market exchange and uproot the private economy in order to build a socialist economy of only state-owned and collective economic organizations of workers.49 The State was to do this, according to the Constitution, by

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47 The Law on Foreign Investment 1987 was an exception to the introduction of market-based laws discussed above, because foreign investment was, in my view, an experimental policy of the Vietnamese government to attract foreign technology and capital for domestic needs, rather than to pave the way for the development of a market economy. This was evident in the 1980 Constitution, Article 18 of which denied commercial freedom to the private sector in Vietnam.

48 See Nguyễn Văn Thảo, (Paper presented at the Quá trình hình thành, phát triển và vai trò của Quốc hội trong sự nghiệp Đổi Mới (trans: Institution, Evolution, and the Role of the Parliament in Renovation), Hanoi, 2001) 21

49 1980 Constitution, article 18
way of nationalization of all private means of production, except some basic means of production of small-scale family businesses.\textsuperscript{50} The drafters of the 1980 Constitution were inspired by the Soviet economic model\textsuperscript{51} to write a chapter on Economy which described the economy as a mega firm under central planning and management of the state, with economic relations between economic units being ordered and structured by the state in its periodical plans in order to eliminate market exchange, which, under Marxian economics, does not create economic value but causes the exploitation of workers’ labor surplus. Therefore, the Ordinance on Economic Contracts was drafted to fit into the legal framework that aimed to support this Soviet-style economic system. After the Doi Moi spirit was formally institutionalized in the 1992 Constitution and the economic system substantially changed from a command system to a market-oriented multi-sector system, the Ordinance on Economic Contracts became outdated in the new constitutional framework.

Second, the preamble of the Ordinance on Economic Contracts provided that the Ordinance was drafted in the spirit of Article 34 of the 1980 Constitution. This article of the constitution read: ‘The State organizes a socialist economy; builds and unceasingly improves the state’s economic management system; applies properly socialist economic theory; implements the democratic principle in vertical (ministerial) management and horizontal (geographical) management; aligns the State’s interests with collective and individual worker’s interests; builds up and

\textsuperscript{50} 1980 Constitution, articles 19, 23, 25

\textsuperscript{51} Vietnam’s 1980 Constitution was drafted to the model of USSR’s Constitution 1977. See Nguyễn Văn Thảo, (Paper presented at the Quá trình hình thành, phát triển và vai trò của Quốc hội trong sự nghiệp Doi Mới (trans: Institution, Evolution, and the Role of the Parliament in Renovation), Hanoi, 2001)
enforces economic laws’. This article, although opaque in many ways, suggests one point clearly: that the intended interpretation theory of the Ordinance should be Marx’s economic theories, which, as I have explained earlier, did not aim to support the efficiency of market transactions. Consequently, the interpretation theory of the law makes the law an instrument for the state to rein in market transactions rather than an instrument to help business people to solve their contracting problems.

The outdated interpretation theory of the law seriously cripples the administration of the law. Because the doctrine of *stare decisis* is not recognized in the civil law tradition, judges mainly rely on interpretation theories and jurisprudence to guide them on how to apply abstract provisions to specific cases, especially when the social-economic conditions of the cases have substantially changed, compared to the time the law was drafted. After the 1992 Constitution – a rather pro-market constitution – replaced the 1980 Constitution, judges who applied the Ordinance on Economic Contracts in contractual disputes that arise in market transactions in the new economic system find themselves with a denied interpretation theory, (that is, orthodox Marxist economic theory) and very little jurisprudence from the Supreme Court to guide them on how to interpret the law in the new constitutional framework.\(^5^2\) In practice, judges faced two hard choices: whether to rely on the outdated interpretation of the law, which would arguably produce undesirable outcomes for the market, or whether,

\(^5^2\) As professor Pham Duy Nghia observed, legal doctrinal writings in Vietnam have not gained popularity for many reasons, among which are legal training and, arguably, political ostracism as a common response to criticism. See Pham Duy Nghia, ‘Confucianism and the conception of the law in Vietnam’ in John Gillespie and Pip Nicholson (eds), *Asian Socialism and Legal Change: The Dynamics of Vietnamese and Chinese Reform* (2005) 76. Also Gillespie, J., ‘Conception of rule of law in Vietnam’ in Randall Peerenboom, *Asian Discourses of rule of law* (ed., 2004) (arguing that communist political ideology is not compatible with the rule of law)
instead, to invent their own interpretation theory, very unconventional thing to do in the Vietnamese legal system.

Third, the orthodox Marxist view of the market in the Ordinance on Economic Contracts also resulted in provisions that aimed to secure compliance with the State’s economic regulations to the detriment of economic efficiency of market exchange.

One example is the narrow principle of freedom of contract. In respect of procedures and formalities, the Ordinance imposes two austere tests on the validity of economic contracts: (1) economic contracts must be in writing, and (2) economic contracts must bear the signature of properly authorized persons. Administrative decrees that elaborated on the law further made these two tests stricter and costlier to comply with.  

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53 In the Vietnamese political system, it was convention rather than the law that the Government could issue decrees to explain the law. Under constitutional law, beside the Parliament, only the Standing Committee of the Parliament is vested with the power to explain a law of the Parliament. See 1992 Constitution, article 91. The government can issue administrative decrees to implement the law through the functioning of its ministries, agencies, and individual members. See Law on the Promulgation of Legal Documents, article 18. However, as administrative power was pervasive in all aspects of Vietnamese lives, and the lack of judicial review gave people no instrument to challenge the effect of administrative decrees, the government’s administrative decrees assumed the effect of the law. The doctrine of judicial review was not available in Vietnamese legal system until the introduction of the Administrative Court into the People’s Courts system in 1995. (See 1995 Law on the Organization of the People’s Courts (Amendments) dated 28/10/1995 by the National Assembly). Judicial review in Vietnam involves only the review of decisions of administrative characters. (See 1996 Ordinance on the Procedure for Administrative Cases, article 4). With the functioning of the Administrative Court, however, people can now challenge the conventional ‘law’ effect of administrative decrees by challenging administrative decisions made under these decrees. The increasing number of administrative cases that have recently been before the Administrative Court; the increasing number of the court’s decisions in favor of individuals against state agencies; and the increasing public opinion supporting the expansion of the Administrative Court’s jurisdiction suggest that the view of administrative decrees as ‘law’ no longer holds. See, for example, Anh Thư, 'Sơ khổ hoạch đâu tước Hà
Technical demands of the Ordinance on Economic Contracts

The State Economic Arbitration, the predecessor of the Economic courts in hearing economic disputes, in its Circular 108/TT-PC dated 19/5/1990 opined that an economic contract must be signed by both sides on the same document; and that only four kinds of ‘documents’ can evidence an economic contract: official letters, telegraphs, orders, or quotations. In a real life business context, this strict procedure arguably excludes informal agreements in the form of relational contracts, where merchants negotiate deals in restaurants, enter into an agreement with a phone call, or a hand shake on tennis courts. In respect of conditions, the Ordinance restricts the right to contract to juridical persons and individuals with proper business licenses. The State Economic Arbitration in the same Circular further limited freedom of contract to agreements for specifically defined purposes: ‘…to produce to an order, to exchange goods or services, to perform a research according to an order, to apply some new technology in production, or to perform an activity for other business purposes with clearly defined rights and obligations of each sides in order to plan and to implement business plans’.

54 This observation of informal contract practice in Vietnam is based on my survey of contract practice in Vietnam in 2004, in which I interviewed thirty local merchants, all of them business owners or managers of private companies, about how they contract and resolve contract disputes. The transcripts of these interviews are on file with the author. See Appendix for the list of interviewees

55 Ordinance on Economic Contracts, article 2

56 Circular 108/TT-PC dated 19/5/1990 of the State Economic Arbitration
Clearly, the Ordinance followed a restrictive approach in describing procedures, formalities, conditions, and contents of economic contracts. This approach conforms to the orthodox view of Marxist economics that the Vietnamese and Chinese law drafters followed at the time the Ordinance was drafted, which saw market exchange as the way class inequality and class exploitation are realized. To avoid these social problems, in a Marxist view, commercial freedom is privilege, not right, and the state should regulate commerce by restricting commercial freedom to licensed economic actors who are, in a planned economy, assigned by the state to perform exchange to implement the periodical economic plans of the state. Supporting contractual efficiency is therefore not an intended purpose of the law.57

**Influence of Chinese legalism**

Finally, Chinese legalism can also be blamed for the restrictive approach of the law in Vietnam. According to Chinese legalists’ theories, as expounded in the works of Han Feizi, a Chinese philosopher who lived before 223 BC, laws should reward those who obey them and punish severely those who dare to break them, even if the result of this would on the face of it appear to be undesirable. Han Feizi gave the story of a gate guard (while on duty) goes to fetch a blanket for the king who has just dozed off. Han Feizi sees the guard as being irresponsible to his official duty and deserving of punishment. Han Fei's philosophy assumes that everyone acts according to one principle: avoiding punishment while simultaneously trying to achieve gains. Thus, the law must severely punish any unwanted action, while at the same time rewarding

57 But see John Gillespie, 'Private Commercial Rights in Vietnam: A Comparative Analysis' (1994) 30 *Stanford Journal of International Law* 325 (Arguing that commercial laws in Vietnam tend to limit commercial freedom because Vietnamese law makers did not have the philosophy of natural rights and the sharing of legal rights between individuals and the state)
those who follow it. In this way it would be guaranteed that every action taken is predictable.\textsuperscript{58} Chinese legalism, manifested in the features of penal orientation and supremacy of the state’s interests over individual interests, have long strongly influenced traditional Vietnamese laws.\textsuperscript{59} The fact that the Ordinance was drafted to reflect the Chinese Economic Contract Law 1982 further demonstrates the embedding of Chinese legalist features in the Ordinance’s restrictive approach.\textsuperscript{60}

\textbf{Doctrinal limitations}

Also because the Ordinance was drafted to be an instrument for the state to control economic activities in the market, rather than for merchants to support the efficiency of their transactions, the doctrine of contract voidability was expanded to the point that it threatened the existence of freedom of contract. The court would declare the whole contract void if one of these four tests were met: (1) the contract promises, either explicitly or implicitly, an action or an outcome that is legally forbidden; (2) a party to the contract does not have a business license that covers the activities to be performed according to the contract; (3) agents are not authorized in writing at the time they enter the contract on behalf of the principle; or (4) deceptive conduct.\textsuperscript{61} In a planned economy, because the primary purpose of contracting between economic units is not to pursue economic efficiency, but to implement the State’s economic

\textsuperscript{58} Fung Yu-lan, \textit{A history of Chinese philosophy} (1952)

\textsuperscript{59} Tai, TV., \textit{The Vietnamese tradition on human rights} (1988) 41. This issue is discussed in more details in Chapter 6


\textsuperscript{61} Ordinance on Economic Contracts, article 8
plans, parties to a contract declared void face disciplinary, administrative, or criminal punishment, and the unperformed part of the contract may be forbidden.  

In the view of contract law as the State’s instrument to implement central economic planning, the Ordinance allows a promisee to punish a promisor for a breach of promise that could arguably cause failure of state-assigned economic plans. Contracting parties can negotiate a penalty for breach of contract up to twelve percent of the transaction value. Penalties can be sought in addition to sequential damages, restitutions or specific performance, and for a wide range of breaches of contract.

I argue here that, although this provision was not drafted with economic theories of exchange in mind, it does, in fact, improve efficiency. One potential objection is that if the law allows penalty for breach of contract, it may induce an opportunistic promisee to refrain from cooperation with the promisor during contract performance. This problem, however, can be fixed by a contributory liability regime, which is available under the Ordinance. In a market of information asymmetry, penalties for breach of contract can arguably help parties to overcome the problem of incomplete contracting caused by prohibitively costly information. For example, assume that in a contract to project exchange into the future, the promisee incurs $10 in *ex ante*

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62 Ordinance on Economic Contracts, article 39

63 Ordinance on Economic Contracts, article 19

64 Ordinance on Economic Contracts, article 29(2)b

65 Ordinance on Economic Contracts, article 30-38

66 A contributory liability regime in contract law would reduce the promisor’s liability for breach of contract in proportion with the promisee’s contributory fault

67 Ordinance on Economic Contracts, article 40
investment which would cause a reliance cost of $10 if the contract is not performed. She also predicts that because information is costly, she could only prove consequential damage of $8 to the court. Consequently, she may refuse to enter the contract if the expected benefit of contracting is less than the expected loss of $2. If she can negotiate with the promisor for a penalty of $2 as the guarantee for her reliance cost not covered by contractual damages, the promisor would arguably agree to provide this guarantee in the form of a penalty clause, if it is efficient for him to do so. The penalty agreement in this situation is therefore Pareto-superior for both parties.  

A law beyond practice

With respect to the relational contract practice, because the Ordinance on Economic Contracts was a transplanted law, borrowed from a legal system which was also unfavourable to the market, it arguably ignores traditional commercial practice in Vietnamese market. At the time the law was enacted, Vietnam was alienated from Western commercial law theories as a result of the bi-polar Cold War, during which Vietnam sided with the Soviet block. The American trade embargo further blocked Vietnam's exchange of legal knowledge with developed legal systems. The Ordinance was drafted following the 1982 Economic Contract Law of China.  

68 In a bargaining game, a strategy is Pareto-superior if it improves the position of both players in the game. Two classics on this are John F. Nash, 'The bargaining problem' (1950) 18(2) Econometrica 155; John F. Nash, 'Two-person cooperative games' (1953) 21(1) Econometrica 128

over market forces. Given the philosophy of ‘commercial law as what commercial people do’, this transplanted contract law did not take into the drafting process the relational contract practice of local merchants, but rather the objectives of the state economic control.

In the light of changes in economic reform, the Supreme Court has attempted to fit the law into the new economic context. In recent guidelines and instructions for lower courts, the Supreme Court bluntly re-interprets the Ordinance. One example is the Council of Justices’ Resolution 4/2003/NQ-HDTP, which significantly narrows the doctrine of contract voidability in the Ordinance, and relaxes conditions and formalities for authorized agents to enter contracts on behalf of their principles. In administration of the law, the court may look for parties’ true intentions instead of strict interpretation of the text of the Ordinance to fill gaps in contracts. One example is *Saigon Metropolitan v. Quang Viet Garment Company*, in which case a dispute arose on an office lease because the lessee vacated the office before the lease expired. The lease did not contain a clause on early expiration. But a relevant regulation, government Decree 56/CP on the leasing of office and house, gives a lessee the right to terminate a lease by giving the lessor a notice of intention 30 days in advance. The Court of Appeals reasoned that the intention of contracting parties, which the court interpreted from the contract and the context in which parties contracted, should be given priority over government Decree 56/CP.

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72 Case No. 21/KTPT, dated 10/4/2003, by the Court of Appeals in Ho Chi Minh City
My view is that the court’s attempt to re-interpret the law does not make the law better ‘rules of the game’ for market exchange. In the Vietnamese legal system, the court does not have the legitimate power to interpret a legislation against the interpretation theory that its drafters intended. In respect of the Ordinance on Economic Contracts, guidelines, instructions, and decisions of the Supreme Court that are not consistent with the intended interpretation theory of the law arguably form a body of case law on contract, which is not recognized in the civil law system of Vietnam. In effect, by departing from the intended interpretation theory of the Ordinance, Supreme Court’s guidelines, instructions and decisions just make the Ordinance more unpredictable for business people who want to structure their transactions around the Ordinance, or try to predict the court outcome to settle their disputes. Even worse, by encouraging lower courts to deviate from the intended interpretation theory of the Ordinance on Economic Contracts, the Supreme Court is giving more power to corrupt and technically incapable judges to interpret the Ordinance in the way that serves their own interests.

My overall argument is that the Ordinance on Economic Contracts was primarily drafted not to provide a legal instrument for merchants to solve their contracting problems, but was in essence an instrument of the state to retain economic control over a planned economic system in crisis by giving limited freedom of contracts to

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73 Law on the Promulgation of Legal Documents dated 12/11/1996, article 52 provides only the Standing Committee of the National Assembly with the authority to interpret laws

74 There is a large literature on economic analysis of settlement of legal disputes, the key idea of which is that litigants negotiate to settle their disputes according to their estimation of the court outcome in order to save court costs. I discussed this literature in Chapter 2
economic actors. Because of this primary aim, the Ordinance on Economic Contracts possesses two inherent problems: (1) the intended interpretation theory of the law is against efficiency of market exchange, because it was founded on Marx’s economic theories; and (2) the law ignores the real life contracting practices of local merchants, who, over decades of a planned economy, learnt the habit of not organizing their transactions around the laws.

More recent attempts of the Supreme Court to re-interpret the Ordinance have not eliminated these inherent problems, because in the Vietnamese legal system the Supreme Court does not have the power to interpret a Law, nor do its judgments have binding effect on lower courts. Fortunately, it is now generally agreed among Vietnamese law-makers that the Ordinance on Economic Contracts should be abandoned as soon as possible.

3. THE CIVIL CODE: THE ROMANO-GERMANIC TRADITION

Unlike the Ordinance of Economic Contracts which was, in essence, a product of the centrally planned economic system in crisis, the Civil Code is another milestone of the evolution of a private law tradition in Vietnam, which re-emerged out of colonialism, wars, and administrative commands. As Ta Van Tai observed, Vietnamese legal history has a long tradition of private law for a rule-of-law society

75 For an argument in the economic literature that economic reform in Vietnam during 1980s begun with some reactionary strategies to maintain Marxian economic principles, and that subsequently led to changes in the legal framework, see Adam Fförde and Stefan de Vylder, From Plan to Market: The Economic Transition in Vietnam (1996) 13- 126

that counts the Lê Code and the Nguyễn Code among its high points.\(^{77}\) The Civil Code is, as I would argue, just the return of this private law tradition with some additional spices including the European civil law tradition and socialist morality.\(^{78}\)

After the Vietnam Communist Party led the nation to liberation in 1945, the private law tradition had a chance to re-emerge. The 1946 Constitution, the first constitution of Vietnam, laid down the foundations for the coming back of the country’s private law tradition. According to the poet Cu Huy Can, who was a member of the drafting committee of the 1946 Constitution, the drafting committee comprised two groups advocating two different constitutional models, both working under the chairmanship of Ho Chi Minh, then leader of the provisional revolutionary government.\(^{79}\) The first group comprised of young Communist revolutionaries who advocated a constitution

\(^{77}\) Nguyen Ngoc Huy and Ta Van Tai, *The Lê Code: Law in Traditional Vietnam* (1987). Oliver Oldman, in the Foreword for the book, commented on the Lê Code, which ruled Vietnam during 14\(^{th}\) to 18\(^{th}\) Centuries: ‘We see in Le law a rather modern legal order, under the rule of law of which lived all members of society except the emperor but including all the ruling officials, and in which there were notions and practices equivalent to present-day Western legal standards, such as the protection of civil liability compensation (including punitive damages) for the victims and the guarantees of procedural due process for the defendants in criminal law, the larger role of public policy in favor of the economically weak in contract law, the consistent and explicit provision of damages payments for all kinds of torts against property, person and reputation, the fair distribution and protection of property ownership, the equality of men and women in civil and property rights, and last but not least, the popularization and standardization of legal forms used among the population.’


\(^{79}\) Cù Huy Cận, *Paper presented at the Qua trình hình thành, phát triển và vai trò của Quốc Hội trong sự nghiệp Đổi Mới* (trans: The process of institutionalization, development and the role of the National Congress in Đổi Mới), Hanoi (2001)
following the Soviet model. The second group comprised of nationalist intellectuals, more familiar with the political ideas of the French Revolution, who advocated a constitution with a bicameral parliament, separation of power, and rule of law. The Constitution of 1946 was drafted as a compromise between the two groups. It conveyed modern political principles of separation of power, rule of law, natural rights, but not a bicameral parliament.

In respect of commercial rights, the 1946 Constitution guaranteed equality of commercial freedoms and private ownership of all Vietnamese citizens. A new government set up under the 1946 Constitution then enacted legislation to continue most colonial private laws these were, in essence, Vietnamese customary laws and codified private laws of the Nguyen dynasty that the French administration received and institutionalized in the forms of court judgment, or legislation. It is arguable that the 1946 Constitution laid down democratic foundations for commercial freedom to develop in a continued private law tradition. But the French attempted to re-invoke Vietnam in 1948, producing a resistance war that culminated in the defeat of the French army in the Battle of Dien Bien Phu in 1954. Subsequently, Vietnam was partitioned into North and South under the Geneva Conference of April-July of that year. American military intervention in the South that invoked the re-unification war

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80 Ibid at 18

81 Ibid. The reader is also referred to David Marr, *Vietnamese Tradition on Trial 1920–1945*, (1981) University of California Press, Berkeley for insightful discussions on the background education of the Vietnamese nationalist intellectuals, many of whom received education from the colonial education system of the French administration but were discontented with the French colonialization of Vietnam

82 1946 Constitution, articles 6, 12

83 Vu Van Hien, *Nen biet qua phap luat Vietnam (about Vietnam laws)* (1949)
until 1975, followed by China’s 1979 invasion of Vietnam in response to Vietnam’s attack on Chinese-support Khmer Rouge in Cambodia, and the American embargo against Vietnam from 1975 until 1994, and the Cold War, in which Vietnam sided with the Soviet block, kept the nation under constant threat of war. In my opinion, as in any society at war, the constant threat of war and actual experience of it that the Socialist Republic of Vietnam faced during 1950s-1980s greatly contributed to the highly centralized control of economic resources of the Vietnam’s Communist Party’s economic policies during the command economy era, and this prevented continuation of the private law tradition in Vietnam.  

There is evidence that efforts to re-build a private law framework resumed as soon as war threats were perceived as distant. A Civil Code Drafting Committee was established in 1980, headed by the Ministry of Justice, with representative participation from various social interest groups (People’s Supreme Court, People’s Supreme Procuracy, Central Fatherland Front, Vietnamese Women’s Union, Vietnamese General Confederation of Labour, Ho Chi Minh Youth League, Vietnamese Lawyers’ Association, Vietnamese Farmers’ Association, Central Administrative Committee, Central Economic Committee, Legal Committee of the National Assembly, Office of the National Assembly and the former State Council, Government Office, Institute of State and Law and the College of Law…).  

In the following ten years from 1981-91, the Committee carried out research including the translation of the civil codes of Germany, France, Japan, Thailand, Canada, the Soviet

84 See also Pham Duy Nghia, Essentials of Vietnam’s Business Law (2001) at 23

Union, Poland, Czechoslovakia, Hungary and China. Legal experts from Germany, Russia, France, Japan were invited to exchange information and opinions. Research missions were sent to Germany, France and Japan to study the process by which their respective civil codes were prepared. Surveys were conducted in a number of domestic localities in North, South and Central Vietnam to make the Civil Code true to real civil life and relations in Vietnam. These extensive efforts to prepare for the Code indicated that Vietnamese law-makers saw the country’s legal system as a civil law system, where a Civil Code is the basic law of private laws.

The predecessor of the Civil Code was the Ordinance on Civil Contracts 1991. Introduced into the contract law system at a time economic activities outside the public sector were still unfamiliar to law-makers, the Ordinance on Civil Contracts regulated a restricted category of contractual arrangements between individuals or households for exchange of consumer products ‘to meet the living and consumption purposes’. The Ordinance on Civil Contracts 1991, together with the Ordinance on Economic Contracts introduced in 1989, constituted the basis of a formal contract law system in Vietnam at that time.

In respect of contracts, the current Civil Code is a universal contract law. It broadly defines contracts in this way: ‘Civil contracts are the agreement between the parties

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86 Ibid
87 Ibid
88 Ibid
89 Ibid
90 Ordinance on Civil Contracts, Article 1
regarding the creation, modification or termination of civil rights and obligations’.  

The Civil Code confers contractual power to all legal and natural persons with civil capacity. Article 94 of the Civil Code provides four tests for the civil capacity of a legal person: (1) Established, permitted to be established, registered or recognized by a competent State body; (2) Being well organized; (3) Having own assets to bear liability on such assets; (4) Entering legal relations in its own name. These are also the main features of corporations under the Enterprise Law. Therefore, all contracting activities in the market falls within the contract law framework of the Code.

On the theoretical foundation of contract law discussed earlier, the Civil Code arguably provides a better contract law framework for contracting in Vietnam than the Ordinance on Economic Contracts. First, the Code was drafted to embrace the traditional contracting practices of local merchants. As I have argued earlier, Vietnamese merchants, due to the discontinuation of the private law tradition in Vietnam during the decades of resistance wars and planned economy, did not have the habit of organizing their economic activities within legal frameworks. Research on real life commercial practice conducted by the drafting committee is therefore extremely important for the Code to embrace real life contract practices into its

91 Civil Code, Article 394  
92 Civil Code, Article 131  
93 Civil Code, Article 94  
94 Civil Code, Articles 110, 113  
abstract doctrines. The Code also inherited civil legislations of the Democratic Republic of Vietnam, which, as I also argued earlier, continued centuries-old private law traditions in Vietnam. This further brings the Code closer to the customs and practices of the people.

Second, as a social institution, the Code theoretically comes closer to a bargaining equilibrium of different interests of different groups in a civil society, because the drafting committee took into account the voices of various social interest groups, not just the leading political voice. The idea here is that social norms emerge as equilibrium of interests of social members, therefore inducing social members to follow the norms. In that way, social norms assume regulatory power without state coercion. A law that resembles a social equilibrium is a law that least provokes law-breaking behavior, because it is better for everyone to follow the law.96

96 The reader can consider, for example, traffic. Many people drive on the left hand side of the traffic not because they are afraid of the police, but because they think it is safer for them to do so. When the majority of people drive on the left hand side of the traffic, driving on the left hand side of the traffic becomes the dominant norm that most people voluntarily follow because it produces a better outcome than other strategies, for example driving on the right hand side of the traffic. The idea of social norms as equilibrium has been discussed in the literature. See, for example, Jack Knight and Itai Sened (eds), Explaining Social Institutions (1995) The idea of ideal private laws as social equilibrium is also implicit in Robert C. Ellickson, Order Without Law: How Neighbors Settle Disputes (1994) (Ellickson observed that ranchers of Shata County followed norms, not laws, because norms came closer to an equilibrium among them.)
Third, as the code was drafted according to the models of the civil codes of France and Germany, which are countries with advanced market economies, the interpretation theory for the code would arguably be the pro-market theories of developed economies, rather than the anti-market theories of Marxian political economics. This makes the Code a better instrument for business people in resolving their contracting problems.

A paradox of the system is, in my opinion, that when the law-makers introduced the Civil Code into the contract law system in 1996, they did not repeal the Ordinance on Economic Contracts. Indeed, they repealed the Ordinance on Civil Contracts, but left the Ordinance on Economic Contracts untouched. Following the division of the People’s Courts into specialized courts in 1994, Economic Courts continue to administer the Ordinance on Economic Contracts to resolve contractual disputes. Matters arising on ‘civil contracts’ are referred to the Civil Courts. In its annual

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97 Although the drafting committee also studied Japanese Civil Code, this model had its origins from French and German models as well. Arguably the concern of the drafting committee when they studied the Japanese Civil Code was to seek understanding of how a Romanist civil code transplanted into a Confucian society worked. For a discussion on the origin of Japanese Civil Code, see Rene David and John E. C. Brierley, *Major legal systems in the world today* (1985) 539


99 For recent contract law cases where the court applied the Ordinance on Economic Contracts to resolve contract disputes, see, for examples, *PAHANCO Corporation Berhad v VIET HUONG Co.* [2003] HCMC’s Appellate court of the Supreme Court (on file with author); *Thanh Phong Paneltec v A&B Foods and Drinks Co., Ltd.* [2003] HCMC’s Appellate court of the Supreme Court (on file with author).
reports and official instructions, the Supreme Court continues to instruct Economic Courts on how to interpret the Ordinance on Economic Contracts in specific contractual contexts. As a consequence, two contract laws exist and are separately administered by two specialized courts of law.

Following the Romano-Germanic tradition, the Civil Code was intended to be the ‘mother’ law, or main trunk, for private law. This interpretation is supported by the structure of the Code, with comprehensive chapters on property law, contract law, tort law, and conflict of laws. Consistent with the Romano-Germanic tradition, the Civil Code provides general doctrines that can override specific provisions of the Ordinance where these provisions are incompatible with the Code’s doctrines. Because Marxian economic theories underlie the way the Ordinance on Economic Contracts was drafted to regulate contracts, the Ordinance is inherently incompatible with the underlying pro-market theories of the Civil Code, unless the text is taken out of its historical context and intended interpretative theory. Accordingly, I think the Code should override the Ordinance in all aspects. In addition, the mechanism by which Civil Courts administers the Civil Code on ‘civil’ contracts, and the Economic Courts administer the Ordinance on Economic Contracts is inconsistent with the logic


102 Rene David and John E. C. Brierley, Major legal systems in the world today (1985)

103 Civil Code, part Two, Three, chapter 5, part Seven

104 This is a principle of interpretation in Romano-Germanic legal tradition. See Rene David and John E. C. Brierley, Major legal systems in the world today (1985)
of legal interpretation. In this logic, economic courts should be ‘within’ civil courts, or, more specifically, specialized chambers of civil courts.

The parallel effect of the Civil Code and the Ordinance on Economic Contracts is, in my opinion, detrimental to the efficiency of contracting in the Vietnamese market. One obvious issue is the line between a contract defined in the Civil Code and a contract entered according to the Ordinance on Economic Contracts. This issue entails the question of which contract law is to be applied to a contractual relation at hand. For example, to overcome the problems of incomplete contracting, contractual parties under the Civil Code can recourse to various hostage measures, many of which are not recognized by the Ordinance.\textsuperscript{105} Procedural laws also give the wronged party in a ‘civil’ contract more time to file a lawsuit than the wronged party in an ‘economic’ contract.\textsuperscript{106} This is further complicated, because the boundary between a ‘civil’ contract and an ‘economic’ contract is, however, not clear. Even lawyers actively engaged in the preparation of the draft of the Civil Code were not certain about the boundary between a ‘civil contract’ and other kinds of contracts.\textsuperscript{107} When two rules of the game are applied to a ‘playground’, it raises the issues of discrimination, law ‘shopping’, and uncertainty as to which law to be applied. In respect of economic contracts, it may be seen that these general and principal provisions [about civil contracts] of the Civil Code in relation to civil transactions, in general and civil contracts, in particular will apply not only to civil contracts but also any other contracts where the relevant law governing such contracts does not provide specific provision’.\textsuperscript{108}

\textsuperscript{105} Comparison of the Civil Code, article 324 with Decree 17-HDBT dated 16/1/1990 of the Council of Ministers to elaborate on the Ordinance on Economic Contracts

\textsuperscript{106} Comparison of the Ordinance on Procedures for Civil Cases effective 1/1/1990 and Ordinance on Procedures for Economic Cases effective 1/7/1994

efficiency, it raises bargaining costs of ex ante contracting where parties negotiate to choose the ‘rules of the game’ for their transaction. If the court system is corrupt, it gives judges more discretionary power to pick the rule they like, for their own benefit.

The Civil Code contrasts with the Ordinance on Economic Contracts in their underpinning theories of regulating contracts. While the Civil Code explicitly supports private efforts to pursue wealth maximization pursues by conferring power to private agreements, and enforces private efforts to maximize wealth, the Ordinance on Economic Contracts aims to maintain the state control over the economic content of contracting activities. Because the Code and the Ordinance are administered by two different specialist courts, with different procedural laws, the effect is two different branches of one contract law system.

Should the contract law system in Vietnam continue to discriminate between ‘economic’ actors and ‘civil’ actors? My answer is that it should not. I take the view that the contract law system does not need an ‘economic’ branch of contract laws. After two decades of reform, Vietnamese society today is totally market-based, ¹⁰⁸ not the planned economy it used to be, when the state aimed to supply and to subsidize all individual needs. ¹⁰⁹ In a market economy, everyone can be an economic actor who involved in economic activities to pursue their needs, and contracting is the daily

¹⁰⁸ See Adam Fforde and Stefan de Vylder, *From Plan to Market: The Economic Transition in Vietnam* (1996) (Arguing that Vietnamese economy was operating under market mechanisms since 1989…)

¹⁰⁹ This attitude was exemplified in Ho Chi Minh’s comment: ‘[I]f the people are hungry, it is the fault of the Party and the Government, if the people are cold, it is the fault of the Party and Government, if the people are sick, it is the fault of the Party and the Government’ in Thanh Duy, ‘Cơ Sở Khoa Học và Văn Hóa Trong Tư Tưởng Hồ Chí Minh Về Nhà nước và Pháp Luật’ (trans: Scientific and Cultural Basis of Ho Chi Minh’s Ideas of State and Law) (1997) *Tạp Chí Công Sơn* 26
activity of everyone’s life, not only companies incorporated for economic purposes. The distinction between pure ‘civil’ exchange and pure ‘economic’ exchange is blurred in real life. If the law arbitrarily forces the distinction, it merely raises the transaction costs of contracting when parties try to organize their transactions within the prescribed procedures, conditions, and formalities of the laws to maximize their welfare.

4. **The Commercial Law: Challenges of Legal Transplants**

The Commercial Law 1997, which aimed to provide a legal framework for business contracts, was, in my opinion, an ineffective law hurriedly drafted from a “hodgepodge” of incompatible commercial law models and foreign legal advices. With the collapse of the Soviet Union in 1991, foreign trade and technical support for Vietnam from the COMECON – the economic organization of former communist states – dried up. To seek alternative sources for capital and high technologies for industrialization, the Vietnamese governments put the task of attracting foreign investment and tapping into the world’s economy on top of their political and economic agendas. As foreign investment poured in during early 1990s, foreign investors and their institutional patrons including foreign governments and international donors urged more commercial freedom in private hands and more transparent ‘rules of the game’ for the market. There were also commitments for

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110 The COMECON (Council for Mutual Economic Assistance) was an economic organization of the Soviet Union with its allies (including Vietnam) that provided Vietnam with most of its needs from foreign trade before *Doi Moi* (Renovation) in 1986. The collapse of the Soviet Union in 1991 effectively ended the COMECON. For a discussion of the interrelation between the collapse of the COMECON and *Doi Moi* policy in Vietnam, see Fforde & de Vylder, *From Plan to Market: The Economic Transition in Vietnam* (1996)
commercial law reform when Vietnam negotiated with the United States to lift the trade embargo in 1994,\(^\text{111}\) and with Southeast Asian nations to join the Association of Southeast Asian Nations (ASEAN) and sign the organization’s free trade agreement (AFTA) in 1995.\(^\text{112}\)

The task of quickly producing a commercial law framework was daunting, because during the pre-Doi Moi planned economy, when market exchange and the private sector were outlawed, a legal framework for market exchange did not exist.\(^\text{113}\) This meant that Vietnamese law-makers at that time faced the task of building a commercial law from scratch. The task was more difficult because of the great shortage of lawyers. Local lawyers were mostly trained in socialist legal systems. They in general lacked knowledge and experience about market economic theories and the functioning of market institutions.\(^\text{114}\) And overall, there was a political pressure for Vietnam to ‘plug into’ the world economy, which, after the collapse of the Soviet Union, had changed from a bi-polar world of capitalist-socialist systems into a uni-polar world of dominant free market systems.


It is now evident that Vietnamese law-makers have chosen a convenient way to quickly produce commercial laws from scratch by borrowing foreign commercial laws. In case of the Commercial Law 1997, three sources of foreign commercial laws were borrowed: German and French commercial codes, United Nations commercial law models and the United States of America’s Uniform Commercial Code. German and French models of commercial laws naturally came into the minds of members of the drafting committee because most of them were trained in France, East Germany or former socialist legal systems that inherited German law tradition.\textsuperscript{115} French legal materials and advice were also available to the drafting committees via the establishment of a Vietnam – French Legal House in 1993 to implement inter-governmental programs of cooperation under the guidance of the two countries’ ministries of justice.\textsuperscript{116} The United Nations Development Program and the United States Department of Commerce jointly kicked in the voices of American commercial lawyers by supplying financial aids and legal experts.\textsuperscript{117} In search for a neutral ground, the members of the drafting committee read into the model laws of UNCITRAL – the United Nations Commission on International Trade Law – for example the United Nations Convention on Contracts for the International Sale of Goods (Vienna 1980) for provisions in relation to contracts.\textsuperscript{118} In particular,

\footnotesize{\begin{itemize}
\item \textsuperscript{115} Claude Rohwer, 'Progress and problems in Vietnam's development of commercial law' (1997) 15 Berkeley Journal of International Law 275
\item \textsuperscript{116} 'France offers to strengthen Vietnam's legal system', Vietnamnet Bridge (Hanoi), 4/3/2005 at <http://english.vietnamnet.vn/politics/2005/03/381845/>
\item \textsuperscript{117} Claude Rohwer, 'Progress and problems in Vietnam's development of commercial law' (1997) 15 Berkeley Journal of International Law 275
\item \textsuperscript{118} Ibid
\end{itemize}}
the underlying political desire of the government to ‘plug into’ the international community after decades of isolation during the Cold War contributed to the propensity for adopting Western laws.\textsuperscript{119} Having been drafted during a short period of preparation and copied extensively from foreign models, the Commercial Law 1997 was a legal transplant, rather than a product that came out of original analysis of economic transactions in the transitional economy of Vietnam.

The Commercial Law 1997 was drafted to relax restrictions on market entry, to spell out more commercial rights, and to provide a more transparent legal framework for commercial activities. In respect of the structure of the contract law system, the Law fits into the branch of contract laws that regulate contracts for ‘economic purposes’, as opposed to contracts ‘to meet living and consumption needs’ which remain governed by the Civil Code. This is because the introduction of the law in 1997 did not change the specialized jurisdictions in the people’s court system.

Civil courts continued to administer the Civil Code on issues in relation to contracts ‘to meet living and consumption needs’. Meanwhile, economic courts continued to administer the Ordinance on Economic Contracts, and now, also the Commercial Law 1997, without referring to progressive features of the Civil Code.\textsuperscript{120} In effect, the arbitrary separation of the contract law system into an ‘economic contract law’ branch and a ‘civil contract law’ branch remained unchanged, although the narrow definition

\textsuperscript{119} Ibid

\textsuperscript{120} Ibid. In his interviews with judges of the Economic Court of Ho Chi Minh City in 1996, Rohwer noted the ignorance of the judges toward the Civil Code, which he was told by the judges was to be separately administered by civil courts, not the economic courts.
of ‘economic contract’ was somehow relaxed by a broader definition of ‘commercial contract’.\textsuperscript{121}

This was, in my opinion, a setback for the contract law system because, although the Commercial Law 1997 was borrowed from advanced Romano-Germanic legal systems, it failed to change the backward mindset of the law-makers who continued to arbitrarily discriminate between ‘economic contracts’ and other market transactions and put the former under a more cumbersome contract law system. In respect of the transparency and intelligibility of the contract law system as a whole, the introduction of the Commercial Law 1997 did not relieve the uncertainty caused by a two-branch contract law system, but rather increased the uncertainty and unintelligibility of the ‘economic contract law’ branch, because it co-functioned with the Ordinance on Economic Contracts.

In respect of the regulatory approach of the law, I notice that the drafting committee for the Commercial Law 1997 received technical consultancy from two legal traditions with different regulatory approaches. The Uniform Commercial Code, the law which legal experts sent by the United Nations Development Program and the United States Department of Commerce were most familiar with, was drafted for a common law system where judge-made law plays an important role in interpreting the law. As a popular feature of the common law tradition, contract law comprises not only statutory law but also case law, which contributes the main part of the law. Statutory contract law in a common law system therefore can be desirably broad, leaving gaps for judicial discretion and for case law to fill. Indeed, lawyers sent by the United States Department of Commerce and the United Nations Development Program

\textsuperscript{121} Commercial Law 1997, article 5(2)
Program urged the drafting committee to draft broad provisions, and to vest more discretionary power in judges to interpret the law and to fill gaps in contracts.\textsuperscript{122} To the contrary, however, law-makers of the Romano-Germanic tradition would tend to restrict discretionary power of judges to interpret statutes, following the famous jargon of Montesquieu that a judge is just a mouth to pronounce the law (\textit{la bouche de la loi}). Laws in the Romano-Germanic tradition therefore tend to be drafted in great detail so as to reduce the discretionary power of judges.\textsuperscript{123} The difference between the regulatory approaches of the two legal traditions has been a major obstacle for many international attempts to unify private laws in the last centuries.\textsuperscript{124}

It appears that the drafting committee of the Commercial Law 1997 was not working with any established theoretical model to resolve the incompatibilities in the regulatory approach of the two traditions. On the one hand, following the broad provision approach of the common law tradition may cause extreme uncertainty for the Vietnamese contract law system in the way the law is administered. Unlike in France and Germany, where lawyers and judges can rely on the huge jurisprudence written by doctrinal writers and law professors to navigate the law, in Vietnam doctrinal writing on contract law virtually does not exist, neither are judges expected to give any weight to jurisprudence outside the text of the law when they make

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\item \textsuperscript{122} Ibid Claude Rohwer, 'Progress and problems in Vietnam's development of commercial law' (1997) 15 Berkeley Journal of International Law 275; Claude D. Rohwer, 'Enforcing new commercial rights in emerging nations' (2002) 15 Transactional Lawyer 3
\item \textsuperscript{123} Of the two model laws of the Romano-Germanic tradition, Germany’s Civil Code has more than 2300 articles, the Napoleonic Civil Code has 2,281 articles
\item \textsuperscript{124} The Hague Conference on Private International Law that begun since 1893 is an example of private law unification attempts. See the official website of the Hague Conference at: <http://hcch.e-vision.nl/index_en.php?act=home.splash>, 3/7/2004
\end{itemize}
\end{footnotesize}
decisions.¹²⁵ One can argue that in Vietnamese legal system, lawyers can rely on political policies in substitution of doctrinal writings to navigate the gaps in the text of the law, but Vietnam Communist Party has officially declared their policy of not interfering with the court’s administration of private laws,¹²⁶ especially in the area of commercial law, where foreign commentators have observed a ‘thin’ rule of law.¹²⁷ In addition, in the Vietnamese legal system, the doctrine of judicial independence is interpreted to mean independent not only as between the judiciary and other branches of the state, but also independence between lower courts and higher courts in the way they apply laws.

On the other hand, members of the drafting committee lacked the knowledge and experience about market economy and market institutions needed to draft detailed provisions on contracts. In the theory of contract law, there is a constraint between maintaining the freedom of contract and introducing default rules. Conventional wisdom says that the more freedom of contract, the better for contracting parties in reaching an efficient deal. This wisdom can be, however, challenged by the now-established knowledge that market players face the problems of incomplete information and bounded rationality so that they are not able to make an efficient

¹²⁵ Pham Duy Nghia, 'Confucianism and the conception of the law in Vietnam' in John Gillespie and Pip Nicholson (eds), Asian Socialism and Legal Change: The Dynamics of Vietnamese and Chinese Reform (2005) 76 (On this point, I made a survey of fifty contract cases decided by the Court of Appeals in Ho Chi Minh City and Hanoi. Nowhere in these cases did I find a reference to a source outside the text of the law. The reports forming the basis of the surveyed cases are on file with the author.)

¹²⁶ Resolution 8-NQ/TW dated 2/1/2002 of the Central Committee of Vietnam Communist Party

deal, or that they could make an efficient deal, but at very high costs of information and *ex ante* bargaining.\textsuperscript{128}

Default rules, if properly designed to mimic the market, can help parties to reduce transaction costs of contracting.\textsuperscript{129} An insider of the drafting committee of the Commercial Law 1997 wrote that the drafting committee at that time was eager to produce detailed provisions because they did not believe that Vietnamese judges had the experience and knowledge to interpret the law to fill gaps in contracts in a mimic-the-market way.\textsuperscript{130} It was a well-founded fear, given the general profile of Vietnamese judges in relation to their legal training, working experience and qualifications.\textsuperscript{131} The question that we can certainly ask is whether the members of the drafting committee were better than the judges in providing default rules that mimic the market so as to reduce transaction costs of contracting in the context of Vietnamese market? Further, it is logically harder for someone to predict the market in a far future than in a near future. From this logical premise, it is arguably harder for members of the drafting committee to produce a specific rule that, after many years since the Law was drafted, would fill a gap in a contract than for a judge sitting to hear contracting parties, now disputants, explaining how the dispute have arisen

\textsuperscript{128} See, for example, Joseph E. Stiglitz, *Information And The Change In The Paradigm In Economics - Nobel Prize Lecture* (2001) <www-1.gsb.columbia.edu/faculty/jstiglitz/download/NobellLecture.pdf> 2004

\textsuperscript{129} See, for example, Ian Ayres and Robert Gertner, 'Filling gaps in incomplete contracts: an economic theory of default rules' (1989) 99 *Yale Law Journal* 87

\textsuperscript{130} Claude Rohwer, 'Progress and problems in Vietnam's development of commercial law' (1997) 15 *Berkeley Journal of International Law* 275

between them and then inventing a rule to fill the gap. In that sense, a broad provision approach to drafting the Commercial Law 1997 could be desirable for regulating contracts in the Vietnamese market, given the fact that the market has been changing very quickly since *Doi Moi* begun in 1986.

Another factor that may have reduced the quality of the Commercial Law 1997 was the mindset of Vietnamese lawyers in the drafting committee. Most of them were trained in Soviet-style legal systems that discriminate between ‘economic’ activities, which need strict state control to reduce ‘negative effects caused by the market economy’, from civil transactions for individual consumption purposes, which were assumed to be less harmful to socialist orientation. A lawyer, Nguyen Dinh Cung, who co-authored the Enterprise Law 1999, recently complained in local newspapers that this mindset is still well-entrenched in the bureaucratic system. He interpreted this mindset in the following terms: ‘The State knows best about the market. The State knows what the society needs and therefore can regulate supply to meet the supply-demand equilibrium’. Although state interventionism is not baseless in economics, socialist economic management represents the radical view of state interventionism. In the case of Vietnam, Cung argued that state intervention in

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133 H. Bac, ‘Bốn năm thực hiện luật doanh nghiệp: mở và đóng (trans: four years implementing the Enterprise Law: closure and open)’, *Tuoi Tre* (Ho Chi Minh), 1/11/2003

134 Ibid

135 State interventionism is also a major macro-economic trend attributed to the classic works of the English economist John Maynard Keynes, usually used in opposition to laissez-faire capitalism or free-market theory based on works of Adam Smith. More recent arguments on economic rationality of state
most circumstances evidenced the old mindset of socialist economic management among state officials rather than because there is a strong case of market failure to justify such intervention. In practice, the Commercial Law 1999 was drafted as a law in the group of laws to regulate economic activities.

**Freedom of contract**

In respect of freedom of contract, the Commercial Law 1997 offers more favorable procedures, formalities and conditions to confer contractual power than does the Ordinance on Economic Contracts. Article 5 of the law defines ‘commercial’ activities to include ‘sale of goods, supply of business services, and other business activities for profit or to implement socio-economic policies’. This definition of commercial activities is clearly broader than the definition of economic activities in article 1 of the Ordinance on Economic Contracts. Consequently, market entry is relaxed because the law confers contractual power to a wider range of market transactions.

However, this definition of commercial activities is still narrow compared with commercial activities in real life that if strictly interpreted, it may well exclude economic transactions in investment, finance (for example, derivatives contracts),

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136 H. Bac, 'Bốn năm thực hiện luật doanh nghiệp: mở và đóng (trans: four years implementing the Enterprise Law: closure and open)', *Tuoi Tre* (Ho Chi Minh), 1/11/2003

banking, construction, franchising etc. An official from the Ministry of Trade, who sat on the drafting committee of the law, later explained that the drafting committee was reluctant to draft a law that regulates economic activities within the administrative jurisdiction of other ministries. According to Article 47, only one of the contracting parties needs to have a business license in order for the contract to have legal effect under the law. This provision relaxes market entry compared with the stringent condition on business license of the Ordinance on Economic Contracts. Article 33 excludes cross-border contracts entered by a local merchant who does not possess a proper license for foreign trade activities. This provision has become outdated because business people are now free to export domestic products without any kind of license, except for a specific group of products that require export licenses such as rice, petroleum, weapon etc.

138 Commercial Law, article 5(2)

139 Nghĩa Nhân, 'Chưa thể sửa đổi toàn diện Luật Thương mại (trans: Unable to re-write the whole Commercial Law now)', VNExpress (Hanoi), 4/7/2002

140 Ordinance on Economic Contracts – Article 2: ‘Economic contracts are agreements between (a) legal entities; (b) legal entities with individuals registered to do business…’. Official Letter 11-KHXX dated 23/1/1996 of the Supreme Court to lower courts to give guidelines on the Ordinance on Procedure for Economic Contract Disputes elaborated on this issue: ‘…at least one of the parties in an economic contract must be a legal entity [companies, agencies…], an individual party of an economic contract must be registered to do business and possess a business license…’. This letter further explained that an individual registered to do business means a single-shareholder proprietary company with limited liability under the law on single-shareholder proprietary company in effect at that time.
Overlapping legislations

The Commercial Law and the Ordinance on Economic Contracts overlap in many instances because both address contracts between registered businesses. To be sure, the text of the Ordinance on Economic Contracts confers contractual power on business entities, not individuals. But under the new Law on Enterprises, an individual can register as a proprietary company with a single shareholder. If he wishes, he can then enforce his contract either under the Commercial Law or the Ordinance on Economic Contracts. This overlapping arguably causes the issue of ‘law shopping’ because the two Laws are not the same, therefore increasing uncertainty in drafting and enforcing contracts.

Both commercial and economic contracts fall within the jurisdiction of the same Economic Court. But the way the Court enforces the contracts is not the same. On the one hand, because the Ordinance on Economic Contracts came into effect in 1989, nearly a decade before the Commercial Law, there is a body of guidelines, instructions, and annual reviews from the Supreme Court on how lower courts should enforce economic contracts by the time the Commercial Law came into effect in 1997. This body of guidelines, instructions, and annual reviews form the authoritative jurisprudence that helps to predict what courts will say, to a limited extent, when courts interpret the Ordinance on Economic Contracts.

Strictly speaking, this body of jurisprudence does not apply to the court interpretation of the Commercial Law. On the other hand, there have not been many instructions from the Supreme Court on how courts should interpret the Commercial Law because the Law is still relatively young, particularly compared with the Ordinance on Economic Contracts. The fact that the legislature made two different contract laws
that co-exist suggests not only to businesspeople, but also lawyers and judges, that the
two Laws should be administered differently. But how differently they are to be
implemented remains, however, a question without answer, because the Supreme
Court is still silent on the issue.

One possible explanation for the lack of authoritative jurisprudence on the
Commercial Law is not because the Commercial Law is a decade younger than the
Ordinance on Economic Contracts, but because disputants have not been eager to test
the Commercial Law. Prospective plaintiffs seeking to enforce promises in the court
normally prefer predictable outcomes. The Ordinance on Economic Contracts has a
body of authoritative jurisprudence and so offers more predictability, especially when
claims come close to established issues in the jurisprudence. Consequently, because
plaintiffs more often invoke the Ordinance on Economic Contracts than the
Commercial Law, the body of jurisprudence on the Ordinance on Economic Contracts
keeps growing, while the jurisprudence on the Commercial Law does not. This is odd
for the Vietnamese contract law system because the Commercial Law was drafted to
be more supportive for free market contracting than the Ordinance on Economic
Contracts. A suggestion on this point is that to encourage the market to embrace a
better contract law system, the Parliament should revoke the Ordinance, and the
Supreme Court should revise the current body of jurisprudence on the Ordinance on
Economic Contracts to be applicable to the Commercial Law.

Relaxing the requirement of the Ordinance on Economic Contracts that economic
contracts must be in writing, the Commercial Code recognizes and enforces oral

141 Ordinance on Economic Contracts – Article 1 requires that economic contracts be ‘in writing, or
exchange of business documents…’
agreements, or contracts gleaned from ‘specific conducts’. However, there is no law to elaborate how the court can glean out a contract from ‘specific conduct’. The Supreme Court has given no guideline or instruction on this matter. Precedents, if any at all, are not law, and are therefore not followed by other courts. And appeal judges have not got used to writing down the reasoning by which they support their decisions. Consequently, it is nearly impossible to know which conduct would form a contract in court.

Poor attempts to help contracting parties to avoid gaps in incomplete contracts can impose additional drafting costs on relational contracting parties. It is costly for contracting parties to negotiate around a default rule that does not serve their interests. Article 50 sets out contents that a contract ‘must have’ in order to be given legal effect. The drafters of the law have probably intended these ‘must have’ contents to be default rules to help inexperienced local merchants to fill gaps in contracts. Local newspapers recently suggested that the experience of the long command economy may have deprived local merchants of market instincts needed to strike efficient deals, therefore, the argument goes, the State should help merchants write contracts, especially cross-border contracts. This sounds like the typical

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142 Commercial Law – Article 49(2) recognizes and enforces sale of goods contracts in ‘oral agreements, in writing, or by specific conducts’

143 This is the premise of the Coase Theorem on transaction costs. See Ronald H. Coase, 'The Problem of Social Cost' (1960) 3 Journal of Law & Economics 1

144 For a discussion of the drafters of the Commercial Law 1997 in relation to this point, see Claude Rohwer, 'Progress and problems in Vietnam's development of commercial law' (1997) 15 Berkeley Journal of International Law 275

145 This argument is found on the experience of Vietnamese import-export companies at the early years of economic reform, when Vietnam was still under the American trade embargo (before 1994).
Confucian political thinking that merchants should look to the State as children look
to their father in the house to protect them from ‘negative effects of market
economy’, instead of self-learning to improve themselves. Whether this
patriarchal approach is good or not for Vietnamese merchants remains an empirical
question, but it is clearly detrimental for the principle of freedom of contract, and the
conventional assumption that the state is no better than economic actors at knowing
what is best for their interests.

**Law not reflecting practice**

In effect, the mandatory contents of commercial contracts may not help merchants to
avoid incomplete contracts, but can deny many commercial arrangements legal effect
under the Commercial Law. A court may declare void a contract that lacks a
mandatory content, despite the fact that it reflects the wishes of contracting parties not
to include this content in their agreement, and regardless of whether such an omission

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146 This thinking is found even among lawyers of top political circles. See Ngo Duc Manh, 'Building up
a legal framework aimed at promoting and developing a socialist-oriented market-driven economy in
Commentaries* (1997)

147 Penelope Nicholson, 'Vietnamese Legal Institutions in Comparative Perspective: Contemporary
Constitutions and Courts Considered' in Kanishka Jayasuriya (ed), *Law, Capitalism and Power in Asia:
The Rule of Law and Legal Institutions* (1999) 300 (Arguing that there is a harmony in Confucian
political culture and socialist doctrines in the pervasive role of the state)
is efficient for them. This is particularly relevant to the highly relational contract practices of local merchants in the market. In relational contracting, merchants tend to seek flexibility for re-adjustment in their business relationships by relying on implicit relational norms developed and tested during their relationship, rather than explicitly writing down clauses in the contract. Drafting a detailed contract may not only increase drafting costs significantly, but may also destroy the good will that nurtured the relationship. In practice, many local merchants that I interviewed said that they would refrain from doing business with a client who insisted on a detailed contract because it signals that the client is not flexible for re-adjustments when the market goes badly. The consequence is that many relational contracts may be excluded from the coercive framework of the Commercial Law, because the court cannot find the mandatory content in the agreement.

The main trunk of the law – from Article 51 to Article 79 – sets out principles on the formation of a sale of goods contract, passing of risk and ownership, and basic obligations of sellers and buyers but does so in a poor manner. While it appears that the drafters of the Commercial Law 1997 have attempted to introduce international standard practice for sale of goods into the domestic economy, very crucial principles are at the same time omitted. Without a body of jurisprudence, it is crucial to

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148 Interviews with judges of the Economic Court of Ho Chi Minh city revealed that the judges tended to view ‘must have’ contents of a commercial contract as mandatory rules the failure to which would make the contract void, rather than seeing them as default rules that parties can explicitly negotiate around. See Claude Rohwer, 'Progress and problems in Vietnam's development of commercial law' (1997) 15 Berkeley Journal of International Law 275


150 Transcripts of these interviews are on file with the author.
contracting parties how courts would interpret a statutory contract law to fill gaps in contracts. The fact is that no matter how well a statutory contract law is drafted, it cannot address all circumstances arising in complex economic transactions. Courts applying the law face the problem of how to interpret the law to fit into the case at hand. Following the principle of freedom of contract, courts are usually advised to pay special attention to contracting parties’ intention, course of dealing, or their history of relationships.\(^\text{151}\) This regulatory approach leaves the difficulty of mimicking the market to Vietnamese judges who, compared to their colleagues in developed Western legal systems, lack both experience of and knowledge about the market.\(^\text{152}\)

To conclude, the Commercial Law 1997 faces serious functional problems. Compared with the Ordinance on Economic Contracts, the Commercial Law 1997 makes some progress toward regulating contracting in a market economy. First, it was not drafted with an anti-market interpretation theory as was the case of the Ordinance on Economic Contracts. Second, it was drafted with local and foreign legal expertise, following commercial law models of advanced legal systems for the purpose of relaxing on market entry and supporting economic efficiency. Nevertheless, there are clearly serious setbacks which, in my opinion, explain why the Law fails to get off the law books to get into real life business transactions.

\(^\text{151}\) For example, the United Nation Convention on Contracts for International Sale of Goods (Vienna 1980)

The first problem is that, like the Ordinance on Economic Contracts, the Law was drafted in ignorance of real life contract practice. Due to great time pressure the Law was drafted, the drafts of the Law were prepared in a short period during which the drafting committee was busy reading foreign laws rather than doing empirical research on real life contract practice, which the drafting committee of the Civil Contract did. Given the well-founded philosophy that commercial law is what business people do, a hurriedly transplanted law will not be able to embrace local contract practice therefore will be difficult to enforce or will impose arbitrary procedures, formalities, and conditions on the relational contract practice in the market.

Secondly, the mindset of strict state control over economic activities still pervades the regulatory approach of the law, resulting in mandatory and default rules that are detrimental to the efficiency of market transactions.

Thirdly, the law was introduced into the contract law system as an additional layer of rules, instead of replacing the old rules. This makes the contract law system more unintelligible and less transparent, resulting in more uncertainty in the way the law is administered. The introduction of the law into the system also failed to address an existing problem of the system, which is the parallel functioning of an ‘economic contract law’ branch and a ‘civil contract law’ branch.

Finally, the Supreme Court has not yet supported the Law with guidelines and instructions for lower courts on the administration of the Law. Economic courts have also not been eager to bring the law into life by applying the law into cases before hand. Consequently, the law remains an exotic product, alien to business people both in theory and in real life disputes. Given that a law is a social institution to guide
people in their interaction with one another so that they can coordinate their expectations to perform cooperative works, a law not in use is an ineffective law because it fails that institutional function.

5. **IMPLICATIONS OF THE THREE SYSTEMS OF CONTRACT LAW IN VIETNAM**

In this article, I examine the functioning problems of the contract law system in Vietnam by discussing the regulatory approach, drafting techniques and interpretation theories of contract law in the systems within the context of economic transition in Vietnam. What I found is a patchwork of contract laws drafted at different stages in Vietnam’s economic transition, largely incompatible with one another in the ways they regulate contracts, and administered by two specialist courts, each not bound by the other’s decisions.

The fact that the contract law system in Vietnam has been built in a short time following foreign models says a lot about the features of the system. This is not, however, sufficient to conclude that the contract law system is weak. One can, in defense, argue that Vietnamese drafters mainly borrowed commercial laws from the developed legal systems of strong market economies. The functioning problems of the system, in my view, have two main causes: the parallel functioning of different contract law branches in the same system, due to contradictory interpretation theories and separate administration of the laws, and the failure of the transplanted system to embrace relational contracting, which is the real life contract practice in the market.

One main feature of relational contracting in Vietnam is that local merchants in a relational contract usually see a contract not as a one-off deal, but as an integral part
of the aggregation of many deals in a long-term business relationship. In this view of contracting, local merchants may not seek transactional efficiency on the basis of each deal they make with a business partner, but on the basis of the aggregated deals of a long-term relationship. Maintaining a long-term relationship in which parties can deal repeatedly is, therefore, very important for economic efficiency. A flexible attitude toward renegotiation when the market changes is also a crucial feature of relational contract practice for local merchants to overcome the problems of incomplete contracting. The inefficiency of one deal is therefore usually tolerated on the basis of mutual understanding that it must be balanced in other deals and that the whole business relationship will thus be efficient. This relational contract practice also interweaves personal deals with business deals, resulting in very personal business relationships.

The current contract law system in Vietnam is, however, not supportive of relational contracts. On one hand, contract rules were mostly transplanted from foreign legal systems, without proper effort to adapt the rules to embrace the relational dimensions of local contract practice and sometimes with anti-market interpretation theories. An imported contract rule that fails to embrace relational dimensions of local contracts tends to single a deal out of preceding, and expected entailing, deals in a long-term business relationship. The radical state interventionist mindset of the Vietnamese drafters also produced pervasive mandatory rules regarding procedures, formalities,

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153 See my forthcoming article Quan Nguyen ‘The Norms and Incentive Structures of Relational Contracting in Vietnam: Two Surveys’ in the Australian Journal of Asian Laws

conditions and contents of contracts, which override voluntarily-created structures of relational contracts, in which local merchants aim to maintain flexibility for renegotiation and to balance current deals with past and future deals in a long-term business relationship to achieve overall efficiency for the whole relationship, instead seeking to maximize profit from one-off deals.

Further, the system discriminates between ‘civil contracts’, ‘economic contracts’, and ‘commercial contracts’. If merchants attempt to bring their relational contracts into the framework of the law, the parallel contract law systems may break down the relational contract into separate deals under different contract law frameworks. For example, one deal which, in the mind of contracting parties, is a part of a relational contract of many repeated deals, may be regulated by the Civil Code as a ‘civil contract’, while other deals in the same relational contract may be regulated by the Ordinance on Economic Contracts as an ‘economic contract’, or by the Commercial Law as a ‘commercial contract’. This breakup of a relational contract into separate deals to be regulated by different contract law frameworks can confuse attempts to organize the relational contract around one contract rule. The consequence is arguably increased transaction costs for relational contracting, that is, for the traditional contract practice of local merchants.155

Parallel contract law systems also worsen the problem of opportunism. ‘Law shopping’ is an example. If a relational contract is organized around a legal rule, when unexpected contingencies arise, an opportunistic party may shop for another rule that helps him/her to avoid regret costs. For example, assume that two merchants organize

their transactions around the limitation rule for civil contracts, which allow parties to bring their disputes to court within one year after the dispute arises. When a dispute actually arises, the wrongdoer may ‘shop’ for the limitation rule for economic contracts, which gives a plaintiff only six months to file a claim. As a consequence, this ‘law shopping’ destroys ex ante planning of the wronged party and therefore may deprive the wronged party of the chance to seek damages. Mandatory rules that impose certain conditions on contractual parties in order to be conferred contractual power also function as a rule to enter the playground, that is, market entry restrictions, therefore causing confusion with business registration regulations and company laws. Mandatory rules in the contract law system may also overlap with property law by not conferring contractual power on exchange of certain resources, therefore effectively denying property rights on these assets.

From a Coasian view of transaction costs of contracting, procedures, formalities, conditions and mandatory rules that the system imposes on contracting parties when they seek to bring their contracts into the framework of the law are cost factors of contracting.\(^{156}\) To maximize their wealth via exchange, merchants contract and economize on transaction costs of contracting. Therefore, I predict that local merchants in Vietnam would refrain from organizing their transactions within the framework of the law.

Instead, they seek to rely on traditional informal mechanisms that can support relational transactions as a whole, therefore assuring overall efficiency for the whole business relationship. The interaction between traditional informal mechanisms to support relational contracting and the formal contract law system makes a special

feature of relational contract practice in Vietnam. From the point of view of contracting as a bargaining game, the existence of multiple contract law systems introduce exit options into the bargaining game of contracting parties. Instead of committing to negotiation within the framework of the formal law, merchants can elect to ‘opt-out’ of the formal contract law system, to borrow Bernstein’s words, if there are social structures other than the law to support their contract.

As I discussed in the previous chapter, the ‘opt-out’ syndrome is an important factor that shapes contract practice in Vietnam because where exit options are available, merchants may elect to stay out of the ‘shadow of the law’ altogether, or to give legal effect to parts of their contractual relations, while still relying on relational institutions to support other parts of the relations. The next chapters of this thesis will discuss these social structures in the Vietnamese market.

Overall, I suggest that to solve the functioning problems of the system, Vietnamese law-makers should focus their effort on synchronizing the system so that there is one common and transparent contract law framework for all market transactions, instead of seeking to borrow more contract laws from developed legal systems. In creating a common legal framework for market transactions, it is desirable that the rules are designed broadly to embrace quick changes in economic activities of a transitional economy. It is desirable that extensive social research is conducted to help law-


makers design legal rules that embrace the relational contract practice of local merchants. This also requires ultimate repudiation of the mindset of radical state interventionism in market transactions. State intervention in the form of mandatory rules for market transactions should be restricted to circumstances where it is evident that there is an issue of market failure.
CHAPTER 6 – THE MERCHANT LAW IN TRADITIONAL VIETNAMESE MARKET

1. THE INFORMAL PATH OF INSTITUTIONAL CHANGES

My survey of contract practice in Vietnam reveals two main features of contracting in this market. The first feature is the way many merchants ignore setting down clear contractual terms during the contracting phase. The second feature is the popular practice of renegotiating of promises during the execution phase of the contract, as the market changes. Consistent with these two features, contract practice in Vietnam is described as ‘popular, oral rather than in the form of written documents’. Surveyed merchants do not contract and resolve contract disputes in the ‘shadow of the law’. To understand the ‘contract’ of local merchants as a piece of private law that determines rights and obligations of contracting parties in their exchange relationship would exclude many relational aspects of daily business transactions in the market which are not regulated by conventional contract law.

As noted already, the standard repeated-game model does not fully explain relational contracting in Vietnam for two reasons. First, if we conclude that surveyed merchants in Vietnam rely on the repeated-game structure to enforce contracts, then how do we define the ‘contract’ in the web of interwoven business and personal relationships of local merchants? The second reason, concomitant to the first, is that in conventional thinking, we can ask: what guides surveyed merchants in their contractual relations if they do not set clear terms for their relations? How do surveyed merchants enforce

their transactions if they do not have a clearly defined set of rights to enforce? The standard repeated-game model does not answer these questions.

As set out in Chapters 2 and 4, the opposite end from the standard repeated-game scale is a social theory of relational contracts. This theory proposes to understand relational contracts not by looking at incentive structures that govern a contract relationship, but by examination of the matrix of social relations within which exchanges take place. Ian Macneil, the pioneer of the social theory of relational contracts, provided two accounts countering the standard repeated-game theory of relational contracting. First, he argues that the application of game theory (or rational choice theory) to contract behavior would 'deal only with transactions as such, sweeping away all relational elements by express or implicit use of ceteris paribus'.

Second, cost analysis of contract behavior, which presumes rational choice, if 'carried out with the utmost of thoroughness would ultimately result in uncovering all significant aspects of the enveloping relations and their interplay with the transaction being studied'. This social theory of relational contracts, coined by Macneil the essential contract theory, proposes that 'it is both more efficient and more sure to engage in combined contextual analysis of relations and transactions'.

While Macneil’s theory may bring us closer to providing an effective tool for understanding relational contracting, it does not fully account for relational contracting in Vietnam. On the one hand, Macneil rightly points out the importance of

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3 Ibid at 375

4 Ibid at 376
the institutional matrix in which the transactions take place. He convincingly argues that the institutional matrix shapes supra-contract norms that govern contract behaviours. On the other hand, his theory provides little guidance as to how the matrix can be navigated. Some legal scholars who have attempted to apply the essential contract theory to analyse real life transactions claim that this theory leads them into a swamp of norms without instruction on how to get out.\(^5\) It is a gap in the theory, which is created by the incomprehensible matrix that necessarily renders the theory incomplete.

Macneil’s proposition that a study of contract relations in a real life market should not ignore the institutional matrix of the market, has foundation. Contract behaviours in the Vietnamese market cannot be comprehensibly explained without assuming the existence of supra-contract norms, which emerge from the institutional matrix of the Vietnamese marketplace, and which govern contractual behaviour in Vietnam. This assumption may fill out the significant gaps in the standard repeated-game model of relational contracts in Vietnam.

But how can we trace the existence of supra-contract norms in the Vietnamese marketplace? How do we map out the institutional framework in which relational contracts take their shape? Is an institutional framework something comprehensible,

\(^5\) Melvin A. Eisenberg, 'Why There Is No Law Of Relational Contracts' (2000) 94(3) Northwestern University Law Review 805 at 813 (‘[C]onstructing a body of relational contract law requires more than rejecting the approaches and assumptions of classical contract law. It also requires the formulation of a new body of legal rules based on approaches and assumptions that are justified by morality, policy, and experience. This is a place to which relational contract theory has not gone and cannot go.’)
or just a ‘sea of customs’,⁶ a swamp of the social context⁷ that once we enter we can never escape⁸.

This chapter proposes that in the contemporary Vietnamese market, local merchants have developed a ‘law merchant’ based on basic Confucian morality to support their exchange relations in the absence of state-sponsored institutions to support the market. It will be argued that basic Confucian morality features the ‘law merchant’ and shapes relational contracting behaviour because of its historical popularity and its practical application in contracting in the Vietnamese market.

The theoretical support for this proposition is the theory of institutional changes. Institutions change incrementally, in a path-dependent way, and in interaction with other institutions and market players in the market.⁹ According to this theory, the dominant institutions in the Vietnam marketplace today are anchored in the institutional framework of traditional markets. The pathways of institutional change therefore can give us clues to identify the dominant institutions of today’s market.

This institutional approach can bridge the gap between the standard repeated-game model and the essential contract theory. On the one hand, that merchants try to

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minimize transaction costs is still the basic assumption of institutional analysis. On the other hand, the social context is taken into account to explain how local institutions emerge to become dominant institutions in the market.

Institutionalists view relational contracting as one main institution of the market. The norms and incentive structures of relational contracting therefore bear the prints of market development. The history of legal development in England, for example, was shaped by the long process of political, social, and economic development in England, and influenced particularly by the export of European political philosophies to England through contact with other European civilizations. The history of legal development in Vietnam clearly has another story with its own path of institutional changes and political philosophies that have influenced and shaped institutional changes. From an institutional approach, examining the path of institutional change in Vietnam can help us to understand the features of relational contracting in Vietnam.

Then what does the path of institutional change in Vietnam suggest to us about supra-contract norms in this market? An examination of institutional changes during the contemporary history of Vietnam reveals the undeniable role of Confucian influence on social institutions underlying the structures of traditional Vietnamese society which govern inter-personal relations. Since the fifteenth century, Vietnamese rulers privileged the orthodox Confucianism system of beliefs, including giving legal effect

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10 Oliver E. Williamson, *The Economic Institutions Of Capitalism* (1985)


12 Oliver E. Williamson, *The Economic Institutions Of Capitalism* (1985) at 15
to Confucian norms as private law in the traditional legal system.\textsuperscript{13} Since the nineteenth century, the Vietnamese state no longer reflects Confucianism as an orthodox political philosophy, but the lack of state-sponsored institutions to support the market is arguably responsible for the continuing influence of Confucian norms in the market.\textsuperscript{14} A line of inquiry for this research is whether Confucian norms play a role in shaping the supra-contract norms of the Vietnamese market today.

The approach taken in this research to the discussion of Confucianism in Vietnam is that it is not a philosophy expounded in classical books or philosophical treatises, as it is in China or Japan, but rather constitutes a range of basic moral norms, which, like contract law, guide merchants in their exchange relationships.\textsuperscript{15} An example of the distinction between philosophy and norms is that between the theory of justice of John Rawls or the philosophy of law of Thomas Hobbes and the laws that regulate people’s conduct in everyday interaction. While many people consciously comply

\begin{enumerate}
\item[\textsuperscript{13}] Võ Văn Hiến, Nên biết qua pháp luật Việt Nam (about Vietnam laws) (1949)
\item[\textsuperscript{14}] Not until economic reform in 1987 (Doi-Moi) did Vietnam start to introduce market-oriented institutions to support the market. See Chapter 5. See also Pham Duy Nghia, Essentials of Vietnam's Business Law (2001)
\item[\textsuperscript{15}] According to Alexander Woodside, there are three reasons that can explain why Confucian was not received as a formal philosophy in the Vietnamese society as it is in China or Japan: (1) There has been little philosophical debate on Confucian in traditional Vietnam, compared with various Confucian schools in traditional Japan; (2) The Vietnamese have a tradition of resistance to Chinese influence; and (3) Confucianism as a philosophy was popular among traditional Vietnamese rulers and bureaucrats during 15th – 19th centuries, but was not able to take root in Vietnamese villages because of the strong political and economic autonomy of Vietnamese communes vis-a-vis the state. Alexander B. Woodside, Community and Revolution in Modern Vietnam (1976) at 104. See also Pham Duy Nghia, Essentials of Vietnam's Business Law (2001) (discussing the political and economic autonomy of Vietnamese communes from the state). Also David Marr, Vietnamese tradition on trial 1920-1945 (1981)
\end{enumerate}
with the law in many situations in their daily lives when they interact with others, it is
not necessary that they do so consciously to honor the social contract propounded in
Hobbes’ philosophy of the law, or to honor justice as explained in John Rawls’
philosophy.¹⁶ Many people comply with the law simply to avoid legal consequences
or to maximize their gains.¹⁷

Nor do I discuss Confucian norms in Vietnam as an identical set of norms to those
understood in China, where Confucius pioneered his ideas, or Korea and Japan, the
other Asian countries that share a Confucian tradition.¹⁸ Social scientists have
generally observed that the common name of Confucian does not necessarily convey
an identical set of norms in these countries.¹⁹ Confucian in these societies is reflected


¹⁷ This is the key assumption in the economic analysis of settlement of legal disputes that I discussed in
Chapter 2 of this thesis

¹⁸ Some Vietnam scholars have further argued that Confucian in Vietnam (known as *Nho-Giao*) is a
mixture of Confucian norms with indigenous communal norms. See, for example, Pham Duy Nghia,
'Confucianism and the conception of the law in Vietnam' in John Gillespie and Pip Nicholson (eds),
*Asian Socialism and Legal Change: The Dynamics of Vietnamese and Chinese Reform* (2005); Pham

¹⁹ For a discussion on the difference between Vietnamese Confucianism and Chinese Confucianism,
see Pham Duy Nghia, 'Confucianism and the conception of the law in Vietnam' in John Gillespie and
Pip Nicholson (eds), ibid; Alexander Barton Woodside, *Vietnam and the Chinese model - A
Comparative Study of Nguyen and Ch'ing Civil Government in the First Half of the Nineteenth Century*
(1971). For a discussion on the difference between Chinese Confucianism and Korean Confucianism,
see Chaihark Hahm, 'Law, Culture, and the Politics of Confucianism' (2003) 16 *Columbia Journal of
Asian Law* 253
in basic moral principles of conduct, which may be similar at the basic level of interpretation but quite different at a more contextual level.\textsuperscript{20}

This chapter does not aim to establish Confucian as a philosophy of relational contracting in the Vietnamese market. What this chapter proposes is that there exists a ‘merchant law’, which features basic Confucian moral norms, and which order relational contract behavior in the Vietnamese market.

\section{2. THE TRADITIONAL MARKET}

Contrary to the common view of an underdeveloped market in contemporary Vietnam, an investigation of historical records of Vietnam prior to French invasion reveals a pre-industrial Vietnamese market place that was vibrant and prosperous, busy with exchange of handicrafts and industrial products from the North and rice and agricultural products from the fertile deltas of the Red River in the North and Mekong in the South. In this pre-industrial agrarian Vietnam, sophisticated agricultural techniques made the country a leading rice exporter to the Southeast Asian region.\textsuperscript{21} Early Western merchants who came to the country to look for trade opportunities during the 18\textsuperscript{th} Century recorded in their travel books busy local

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\textsuperscript{20} Pham Duy Nghia, for example, provides some interpretations of Confucian norms in the context of Vietnamese agrarian life and argues that indigenous norms blend with Confucian norms to become the customary laws of the communes. See Pham Duy Nghia, ‘Confucianism and the conception of the law in Vietnam’ in Penelope Nicholson and John Gillespie (eds), ibid; Pham Duy Nghia, Essentials of Vietnam’s Business Law (2001) 12-16

\textsuperscript{21} Anthony Reid, Southeast Asia in the Age of Commerce 1450 - 1680, Volume Two: Expansion and Crisis (1993)
markets, North-South domestic trade routes, and sea ports in the South for rice export.\(^{22}\)

The *Đại Nam Thức Luc* (Official Records of Đại Nam, Official History of the Nguyễn) reported a 19\(^{th}\) Century Vietnamese king proudly comparing his country’s agricultural technologies with those of a less agriculturally-developed neighbouring country:

‘[t]he [neighbouring country’s] people do not know the proper way to grow food. They use mattocks and hoes, but no oxen. They grow enough rice to have two meals a day, but they do not know how to store rice for an emergency’.\(^{23}\)

In Southern Vietnam, commerce was and is favoured by the geographical and environmental conditions. Markets have thrived not only as instruments for farmers and middlemen to exchange agricultural production surplus, but also as survival instruments for local people. The Mekong Delta in Southern provinces of Vietnam is a low-land region covered by nine main distributaries of the Mekong River, where it flows into the sea. The Vietnamese calls this region *đồng bằng sông Cửu Long* (Nine Dragons River’s delta), referring to the nine distributaries of the river that cover the basin. The Mekong River is famous for its length (the twelfth longest in the world and traversing seven countries, Tibet, China, Myanmar, Thailand, Laos, Cambodia and Vietnam); its water volume (tenth largest by volume); and its floods in rainy seasons. The Chinese term the Mekong the *Lancang* (turbulent river), the Cambodians call it

\(^{22}\) See, for example, John White, *A Voyage to Cochin China* (1824), George Finlayson, *The Mission to Siam and Hue, the Capital of Cochin-china, in the years 1821-1822* (1826)

the Tongle Thom (great river), with the Vietnamese following suit, coining it the sông Cửu Long, or sông Lòng (Great river).\textsuperscript{24}

The region of low land in the Vietnamese basin cities, Cần Thơ and Long Xuyên are only one to three metres above sea level and hence very susceptible to the tides of the Mekong River, which vary some four-metres between flood and ebb tides.\textsuperscript{25} The impact of the floods is doubled-edged for the local people. In rainy seasons lasting half of the year, many residential areas in the Mekong River basin are inundated and local people can face great hardship and may be forced to rely upon goods supplied from the outside. Counteracting these negative consequences, the annual Mekong River floods make the basin extremely fertile for agriculture and fishing, generating rich sources of food, employment and transport. The combination of three factors, the need to exchange goods with others, fertile soil that produces agricultural surplus, and water ways for easy transportation by boat means that commerce is a natural part of the lives of the Mekong basin-based people.

In Northern Vietnam, markets thrived in servicing to the relatively dense population of the kingdom’s capital (Đông-Kinh or Tongkin). Markets existed not only for exchange of agricultural production surplus of the fertile Red River delta, but also for the exchange of handicrafts and industrial products produced in specialized villages and wards in and around Tongkin. Northern markets were highly specialized markets for crafts and industrial products, organized and run by commercial guilds in different communes or clans. As described by Woodside, ‘Nineteenth Century Hanoi

\textsuperscript{24} John Keay, Mad About The Mekong: Exploration and Empire in Southeast Asia (2005)

(Tongkin) was divided into blocks or wards, each of whose inhabitants followed the same trade – hemp stores, tin shops, sail shops, bamboo basket shops, sugar retailers – and often came originally from the same native or village.\textsuperscript{26} The common name used by Vietnamese people to characterize Hanoi: ‘
Hà Nội ba sáu phố phường’ (Hanoi of thirty six wards) suggests that Tongkin by the 19\textsuperscript{th} Century was comprised of thirty six specialized industrial suburbs.

The social structure of Northern villages and suburbs around Tongkin were dominated by commercial guilds of artisans, farmers and specialized merchants. Most artisans were grouped in villages or village chains (potters, weavers, boat-builders, for examples). Most of Hanoi’s industrial products came from highly specialized villages (for examples, villages that produced silk or cotton tiles, bricks, castor oil, pots, boats, reed-mats, etc.) and their goods circulated throughout a given province.\textsuperscript{27}

Because of the organisation of highly specialized labour according to geographical residence, industrial products circulated widely.\textsuperscript{28} Sophisticated divisions of labour amounted to 'village chains', where each village carried out a specific production step, that is, pottery would be baked in one village, ornamented in another and painted in a third. And in the neighbourhood of big cities such as Hanoi, particular localities developed semi-monopolies over famous products, for example, the inlaying of mother-of-pearl was performed in three hamlets which, later were incorporated into the city of Hanoi, to become the city's Pearl Inlayers' Street; umbrellas for officials

\begin{itemize}
\item \textsuperscript{26} Alexander Barton Woodside, \textit{Vietnam and the Chinese model - A Comparative Study of Nguyen and Ch'ing Civil Government in the First Half of the Nineteenth Century} (1971) at 32
\item \textsuperscript{27} Jean Chesneaux, \textit{The Vietnamese nation} (1966) at 54
\item \textsuperscript{28} Ibid at 54
\end{itemize}
were made in the village of Hien-Luong, near Hanoi; and so on. The names of streets, suburbs and localities in modern Hanoi still commonly reflect their traditional trade specializations.  

Early Western merchants who came to Vietnam during 18th and 19th Centuries searching for trade opportunities were impressed by the busy local markets. When George Finlayson, a Scottish surgeon and naturalist (who accompanied John Crawfurd, the leader of the English East Indian Company mission to Thailand and Vietnam in 1821-1822), visited Saigon, he toured busy marketplaces where diversified agricultural products changed hands in large quantity:

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\text{such commodities as are used by the natives were to be found in great abundance in every bazar. No country, perhaps, produces more betel or areca-nut than this. Betel-leaf less abundantly; fish, salted and fresh, rice, sweet potatoes, of excellent quality, Indian corn, the young shoots of bamboo, prepared by boiling, rice, the germinating state, coarse sugar, plaintans, oranges, pumeloes, custard, apples, pomegranates, and tobacco, were to be had in the greatest quantity. Pork is sold in every bazar, and poultry of an excellent description is very cheap.}^{30}
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In contrast to the abundance of agricultural produce, industries had stunted development in Southern Vietnam. Finlayson noted in his journey: ‘…there being, in fact, little or no manufacturing industry here…everything else was imported from the

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29 Ibid

30 George Finlayson, \textit{The Mission to Siam and Hue, the Capital of Cochin-china, in the years 1821-1822} (1826) at 310
surrounding countries. In exchange, their territory [Cochin-China] affords rice in abundance, cardamoms, pepper, sugar, ivory, betel’.

Woodside proposed four reasons why exchange of crafts and industrial products did not develop on a large scale in Vietnam: First, Vietnamese crafts were subordinate to agriculture. Only villages with poor agricultural potential specialized in crafts. Second, village solidarity blocked mass production, because villagers hid their traditional craft formulas from outsiders. Third, industry and commerce found it difficult to exist in such a small country with a centralized, pervasive, Chinese-style bureaucracy because the Vietnamese court controlled craft guilds and taxed their artisans out of business. Fourth, Vietnamese artisans had to compete with imported products from China.

Distant trade was most developed in Southern Vietnam, particularly via the Gia Định’s port, now the international port on Sài Gòn river in Hồ Chí Minh city. Gia Định became a dominant rice exporter to the region when big neighbouring markets started to open up in the early nineteenth century as the Southeast Asian island regions began to expand economically, especially with the active incursion of the British imperial forces. Demand for Vietnamese rice drastically increased with the formation of Singapore in 1819. During Minh Mạng’s reign (1820-1841), illegal

31 Ibid
34 Ibid at 70
rice export was pervasive because rice in Southern Vietnam was half the price of rice in China and Southeast Asian countries. Of great concern to the Huế Court at that time was the control of the export of rice from Southern Vietnam to Northern Vietnam and China.\textsuperscript{35} Trafficking rice was severely punished by the court and many local and foreign merchants were executed for illegally exporting rice.\textsuperscript{36}

Maritime trade was the most popular method of distant trade. Vietnamese ships monopolized rice transportation and travelled to Southeast Asian countries and Hai Nan to export rice.\textsuperscript{37} When John White, an American merchant, arrived in Saigon, Siamese ships shouldered with ships from China along Đông Nai river, awaiting passes from state vessels and paying taxes to the custom house, to export rice.\textsuperscript{38} Trading vessels from Northern Vietnam loaded with fire-wood, ship-timber, iron and large jars travelled along the sea coasts to Saigon via Đông Nai river to exchange sugar, rice, salt etc.\textsuperscript{39}

Due to the close proximity and shared historical social intercourse between Vietnam and China, Chinese settlers also played an important role in market development in traditional Vietnam. In 1679, the Nguyen state allowed three thousand Ming Chinese refugees to settle in Gia Định land, shifting the epi-center of Chinese residence to

\textsuperscript{35} Alexander Barton Woodside, \textit{Vietnam and the Chinese model - A Comparative Study of Nguyen and Ch'ing Civil Government in the First Half of the Nineteenth Century} (1971)

\textsuperscript{36} John White, \textit{A Voyage to Cochin China} (1972) 235


\textsuperscript{38} John White, \textit{A Voyage to Cochin China} (1972) at 55

\textsuperscript{39} Ibid at 81
Saigon from Hội An. Following the settlement of the Ming Chinese refugees in the Gia Định region, (especially in Mỹ Tho and Biên Hòa,) these areas developed into commercial centres in which 'Chinese, Westerners, Japanese, and Malay traders were bustling'.

The Chinese settlers in Vietnam were generally content with their membership of the merchant class within society. A common assumption is that the Chinese settlers in 19th Vietnam were a powerful merchant group as they were in other Southeast Asian countries at that time. George Finlayson met a few Chinese merchants when he toured markets in Gia Định. He wrote in his handbook that the few Chinese settlers he met in the markets ‘carry on trade on an extensive scale’, while the indigenous people of Gia Định are for the most part too poor to engage in large scale trade.

Vietnamese Chinese settlers were also scattered throughout the kingdom, and participated in mercantile pursuits as well as many of the humbler aspects of life. According to John White’s description of Chinese merchants in traditional Vietnam: ‘These industrious and enterprising people are the butchers, the tailors, the confectioners, and the pedlars of Cochin China: they are met with in every bazaar, and in every street, with their elastic pole carried across their shoulders, at the end of

40 Choi Byung Wook, *Southern Vietnam under the reign of Minh Mang (1820-1841): Central policies and local response* (2004) at 38 citing Ts'ai T'ing Lan, Hai Nam Tap Tru (Various records of the lands beyond the southern ocean) (1836) 7


42 George Finlayson, *The Mission to Siam and Hue, the Capital of Cochin-china, in the years 1821-1822* (1826)

43 Ibid at 315
which is suspended a basket filled with their various commodities; they are also the bankers, and money-changers, and a great part of the circulating medium of the country passes through their hands’. 44

Overall, Vietnamese industry in the nineteenth century was characterized by an already complex organization for the distribution of its products. 45 In Northern Vietnam, specialization of labour, the primal root for exchange, 46 was extensive caused by the labour surplus in the agricultural sector due to dense population and limited farming lands. In Southern Vietnam, specialization of labour was less extensive. But markets thrived on the exchange of abundant rice and agricultural products from the very fertile lands.

These descriptions of the major market patterns in traditional Vietnam provide support for my proposition that market exchange was sophisticated and highly developed in Vietnam prior to the French invasion in the mid-19th Century. In this pre-industrial agrarian economy, domestic market exchanges, noted by Woodside, most likely followed this pattern: 'producers – periodic markets – consumers'. 47 Similarly, the pattern of market exchange in export markets was most likely: producers - wholesale merchants/exporters - foreign buyers.

44 John White, *A Voyage to Cochin China* (1972) at 261-2

45 Jean Chesneaux, *The Vietnamese nation* (1966)at 54


3. THE LAW OF THE TRADITIONAL MARKET

Woodside characterizes Vietnam during the 15th - 19th centuries as ‘Confucian Vietnam’ because it was dominated by the political orthodoxy of the dynastic rulers of this time. Arguably, Confucian norms in dynastic Vietnam were able to constitute a social institution that ordered inter-personal relations in traditional Vietnam and coordinated expectations in the market for the purpose of organising exchange transactions. Confucianism was able to gain this ordering function in traditional Vietnam not only because of its status as ideological orthodoxy, but also its institutional structure, which is composed of a set of both popular norms that guide people in their inter-personal contact, and social mechanisms that enforce the underlying norms.

First, Confucianism offered ‘an ethical code grounded on social virtue to guide the individual through the maze of his social and political relations.’ Far from being an abstract philosophy, the core of Confucianism is a set of moral rights and obligations clearly defined for prescribed social roles in inter-personal relations. At the centre of Confucian philosophy is an ideal social figure, the superior man, who diligently performs his social roles. Confucius believed that if everyone upheld their social roles, society would be in order without the need for law. For Confucians, social order

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49 Ellen Hammer, Vietnam yesterday and today (1966) at 40
depends on conformity to (Confucian) codes of conduct, not individual self-
determination according to one's nature, talent or interests.50

The more abstract aspect of Confucianism, the political philosophy, is derived from
Confucian scripture, which is composed of two parts. The first is the Five Classics,
which existed long before Confucius’ time but was first edited by Confucius, (and
which consists of the I Ching or Book of Changes; the Shih Ching or Book of Odes;
the Shu Ching or Book of History; the Li Chi or Book of Rites; and the Ch’un Ch’iu
or Spring and Autumn Annals). Second, there are interpretations of Confucius’
teachings, grouped together by his disciplines under the collective title of The Four
Books (which consist of the Ta Hsueh or Great Learning, the Chung Yung or Doctrine
of the Golden Mean, the Analects, and Mencius).51

Confucius’ ideas are centred upon five basic interpersonal relations which he believed
formed the core of all social relations: King-mandarins, father-son, husband-wife,
elder brother-younger brother, and friend-friend. These interpersonal relations are
deﬁned by moral rights and obligations developed upon five doctrinal foundations:
nhân (benevolence); nghĩa (righteousness); lễ (rites, decent politeness); trí (wisdom);
and tìn (trust). Beside these doctrines, Confucius believed that there were universal
virtues that would enhance the superiority of the superior man in performing whatever
social roles he undertook. Those virtues include: reciprocity, the doctrine of Golden
Mean (trung dung in Vietnamese, which means the balance is the best), and strong

50 Stephen B. Young, 'The orthodox Chinese Confucian social paradigm versus Vietnamese
individualism' in Walter H. Slote and George A. De Vos (eds), Confucianism and the family (1998)

The Vietnam Forum 13
will. Each social role was surrounded with an elaborate exegesis and historical case law.  

Second, the social structures of traditional Vietnam helped to enforce Confucian norms. As an overall description, traditional Vietnamese society was comprised of three main social organizations: the royal court, the village and the family. Each of these three organizations operated as a social mechanism for enforcing Confucian norms.

Education was probably the most important social mechanism for enforcing Confucian norms. By way of education, the masses internalized and unified their understanding of Confucian norms. A unified understanding of Confucian norms was critical if Confucian norms were to become a useful instrument for daily interpersonal contacts. People knew that if they practiced Confucian norms, they could coordinate their expectations in the performance of social tasks. Once Confucian norms reached a level of common understanding in their meaning, they could become a useful instrument for interpersonal intercourse, providing an incentive for people to learn Confucian norms so that they could participate in its benefits. It is through this sort of evolutionary cycle that Confucianism emerged to become a powerful social institution in traditional Vietnam.

The greatest motivation for learning Confucianism was state examination for the recruitment of mandarins. During the Tran dynasty (1225-1400), imperial

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examinations were conducted to recruit administrators based on the application of Confucianism to government practice. As the Vietnamese saying goes: ‘một người làm quan cả họ được nhờ’ (if one becomes a mandarin, the whole clan benefits), and so the prospect of changing life and social status - not only for oneself but also one’s clan - was so great an incentive that many young men devoted their whole youth to studying Confucianism. Not only did Confucian students have a chance to become mandarins, they could also climb the village hierarchy. The notables of the village were usually landed gentry, Confucian students, and elderly and respected citizens. This social hierarchy of the village provided additional incentives for families to invest in their children’s Confucian education.

The physical configuration of the village was conducive to the propagation of Confucian norms, creating a village-level stronghold of Confucianism. The village lay in the middle of the fields and was usually surrounded by a hedgerow of bamboo. In the words of professor Pham Duy Nghia:

Unlike the Western society, villages of the Viet people were (and to some extent still are) a basic residence form, a self-sufficient economic unit, politically the grassroots administrative unit of the State and at the same time a highly self-ruled community.

Within these confines, all village members lived under the watchful eyes of one another and within walking distance of the Confucian temple and the village school. From a political standpoint, the old Vietnamese saying that the ‘orders of the emperor

55 Nguyen Khac Vien, Vietnam A Long History (1993) at 53


bend before the customs of the village’ (*phep vua thua le lang*) illustrates the fact that members of the village paid higher respect to the village’s customs and traditions rather than the law.  

Some scholars in Vietnam believe that a proximity between Confucian ideas and Vietnamese agricultural life style explains the successful incursion of basic Confucian moral norms into Vietnamese society. Vietnamese scholars such as Pham Duy Nghia and Kim Dinh argued that Vietnamese ancestors who occupied the Southern areas of the Yangze River in China contributed to the ‘ancient knowledge’ that Confucius collected and edited to form his philosophy. Confucius himself claimed never to have invented anything, but rather was only transmitting ancient knowledge (*Analects* VII, 1). Whether this claim is true or not, according to Pham Duy Nghia the complementarity between basic Confucian morality and Vietnamese agrarian lifestyle explains why Confucian morality was so deeply entrenched in traditional Vietnam,

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58 The commune (or village) was an autonomous administrative organization within the nation in traditional Vietnam. It is a fact widely recognized by Vietnam scholars that the commune constitutes a great regulatory force in traditional Vietnam, although what is still debatable is the matter of degree of the autonomy of the commune in Vietnam when the state’s laws conflict with the commune’s norms and practices. See also Nguyen Van Huyen, *The Ancient Civilization of Vietnam* (1995) at 77


60 Confucius, *The Analects* (1998 ed,
despite the adversarial history between Vietnam and China, and for so long after Chinese domination was overthrown in the early 10th Century.61

There existed a clear distinction between, on the one hand, Confucianism as a philosophy of government, only accessible to a small group of elite (rulers, mandarins, and the elite intellectuals), who, according to Confucian philosophy should not practice commerce; and on the other, Confucianism’s role in providing some basic principles for daily interpersonal contact, which the population applied as their daily way of living.62 However, over the centuries Confucian norms gathered strength and became widely practiced by the population. From the emperor down to the humblest peasant, from the public domain to the most private areas, no decision was ever taken, no deed justified, no judgment pronounced, and no human communication established, without explicit or implicit reference to basic Confucian norms.

Third, aside from the social structures of traditional Vietnam, Vietnamese rulers eagerly enforced Confucian ethical norms as the substantive law governing citizen-citizen relationships. Confucian ethical norms rose to eminence in the regulatory approach of the two great codes of feudal Vietnam, Quoc Trieu Hinh Luat, the penal


62 There are four distinct social classes in Confucian philosophy: the intellectuals as the ruling class; the farmers; the industrialists; and the merchants. In Confucian social ranking, the intellectuals are the most, and the merchants the least, prestigious class. See, for example, Nguyen Ngoc Huy, 'The Confucian incursion into Vietnam' in Walter H. Slote and George A. De Vos (eds), Confucianism and the family (1998); Nguyen Phuong Lam, 'Confucian society and colonial puritan society in New England' (1984) 15(4) The Vietnam Forum 13; Ta Van Tai, The Vietnamese Tradition of Human Rights (1988)
code of the Le Dynasty (which ruled Vietnam for almost three hundred and sixty years (1427-1788)), and the *Hoang Viet Luat Le*, or the Nguyen Code, of the Nguyen Dynasty, which was operative in Vietnam until its repeal by the French administration (by Article 1954 of the 1931 Civil Code for Tonkin and by Article 1708 of the Civil Code for Annam).  

Both the Le Code and the Nguyen Code were drafted drawing upon Chinese law models. The Le Code was influenced by the T'ang Code and to a much lesser degree, the Ming Code. It was promulgated at the end of the 15th Century, and remained in force until the 19th Century. A key feature of the Le Code, was that although it followed Chinese law models, its drafters adapted it effectively to its Vietnamese context, incorporating many specifically Vietnamese provisions which reflected an effort to maintain Vietnamese popular customs and practices and to resist blind borrowing from China.  

It provided civil procedures for civil disputes, but recognized and enforced customary laws on market exchange. The impact of the T’ang Code was primarily on the Le Code chapters dealing with criminal matters. It secondarily influenced the chapters on administrative and military matters. Thirdly, It also (only very slightly) affected the chapters on civil law. The Nguyen Code was a step backward in comparison with the Le Code. Promulgated in 1802 to replace the

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64 Ibid at 54

65 Vũ Văn Hiến, *Nên biết qua pháp luật Việt Nam (about Vietnam laws)* (1949) at 34

Le Code, the Nguyen Code was a direct copy of the Ch’ing law from China.\textsuperscript{67} It did not recognize or provide for the enforcement of local customary laws, a deficiency which was only partially corrected by subsequent amendments, resulting in limited attempts to recognize and enforce customary laws on market exchange.\textsuperscript{68}

Like traditional Chinese law, traditional Vietnamese laws were in the form of criminal law, enforcing moral ethics through penal sanctions. The original title of the Le Code was Quoc Trieu Hinh Luat (The Penal Code of the National Dynasty). The state used penal sanctions (slashes, strokes, imprisonment, fines, physical costs) against violations of the law.\textsuperscript{69} The mandarin in charge of administering the law and its enforcement bore the title of \textit{Thuong-Thu-Bo-Hinh} (Minister of Penal Law Ministry).\textsuperscript{70} The standard drafting formula for legal rules was: ‘Whoever does A shall receive punishment B’.\textsuperscript{71} This regulatory approach also applied to civil disputes. In civil litigation, the state punished the defendant if the plaintiff won, or punished the plaintiff if the defendant won.\textsuperscript{72}

\textsuperscript{67} Vũ Văn Hiến, \textit{Nềん biết qua pháp luật Việt Nam (about Vietnam laws)} (1949) at 32

\textsuperscript{68} Ibid at 35

\textsuperscript{69} Ibid

\textsuperscript{70} Ibid at 24

\textsuperscript{71} Nguyễn Ngọc Huy, Ta Văn Tài and Trần Văn Liêm, \textit{The Le Code: law in traditional Vietnam} (1987) at 55

\textsuperscript{72} Vu Van Hien, \textit{Nen biet qua phap luat Vietnam (about Vietnam laws)} (1949)
A central feature of traditional Vietnamese law is the Confucianization of the law.\textsuperscript{73} In both the Le Code and the Nguyen Code, ‘many moral precepts were considered legally binding’.\textsuperscript{74} Infractions of Confucian morality were treated as criminal violations.\textsuperscript{75} Lack of filial piety was considered a heinous crime. Marriage during mourning for one’s parents or during their detention was punishable. People were permitted in most circumstances to conceal crimes committed by their relatives.\textsuperscript{76}

Confucianization of the law also resulted in the application of inconsistent penalties for the same offence according to where the parties fitted into the different classes of the Confucian social hierarchy. The penalties differed according to the class and family status of the offender and the victim.\textsuperscript{77} Privileges (both procedural and substantive) were extended to those who enjoyed one of eight ‘special considerations’ or to officials.\textsuperscript{78} On the other hand, there were legally defined disadvantaged social categories such as serfs or entertainers.\textsuperscript{79} Penalties also varied according to the position of each individual in his or her family and other characteristics perceived as

\textsuperscript{73} Nguyen Ngoc Huy, Ta Van Tai and Tran Van Liem, \textit{The Le Code: law in traditional Vietnam} (1987) at 41

\textsuperscript{74} Ibid at 68

\textsuperscript{75} Ibid at 41

\textsuperscript{76} Ibid at 56

\textsuperscript{77} Ibid at 56

\textsuperscript{78} Ibid at 57

\textsuperscript{79} Ibid at 56
relevant, such as seniority, sex, or degree of kinship (measured particularly in cases concerning degrees of mourning).  

Private exchanges were only partially regulated by the Le Code the provisions of which were limited to those that promoted fairness in transacting, and protected private ownership of properties, mainly land, in conveyancing. Even this modest regulation of private law disappeared entirely in the Nguyen Code, leaving private exchanges to be wholly governed by customary norms mainly derived from Confucian morality. Particularly in relation to property and contract in the traditional codes, the moral norms of li described rituals and rules governing the relationships among the persons.

Confucian norms gained supremacy over other customary and religious norms in the market because the Nguyen Code harshly suppressed Buddhism and Taoism and their exponents. The Gia-Long code contains for very severe provisions against priests of these religions: 40 strokes of the rattan cane for those officials who allowed their wife or daughter to attend Buddhist, Dao or genie temples;(Article 143 of the Gia-Long Code); exile (to 3000 miles) for ‘men and women expounding pernicious doctrines’,

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80 Ibid at 56.
81 Ibid at 42
82 Ibid
and adepts of sorcery and magic (Article 144 of the Gia-Long Code); and 80 strokes of the *truong* for those who, without authority, shaved their heads or wore their hair in the manner of the Taoist bronzes, ‘useless wasters of the people’s wealth’ (Article 75 of the Gia-Long Code). 85

Confucian influence on the law did not end during the French colonial occupation in the 19<sup>th</sup> Century. During the colonial period, Vietnam was divided into three separate territories under three administrative regimes: Cochinchina (South Vietnam) was administered as a French colony; Tongkin (North Vietnam) as a semi-colony and semi-protectorate territory; and Annam (Central Vietnam) as a protectorate territory. 86 Although the French administration did introduce French civil law tradition into the country, it is arguable that French laws did not replace the Confucianized customary laws and practices of the Vietnamese ordinary people in their daily market exchanges.

First, the French ruled the country via a puppet Nguyen royal court. Confucian examinations to recruit mandarins for the puppet royal were preserved until 1916. 87 French governors who sit in major provincial cities administered via local village chiefs, who continued to apply indigenous laws and practices in their administration of all aspects of the Vietnamese life. This policy helped the French to cope with the strong nationalist and hostile attitude of the Vietnamese people toward their presence. The French historian Cultru wrote:

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85 Nguyen Ngoc Huy, Ta Van Tai and Tran Van Liem, ibid.


87 Ibid at 161
[i]f by some miracles, the scholars had come over to the French and betrayed their sovereign, the administration of Cochinchina would have been perfectly straightforward. But the learned Annamites, the elite faithful to the laws of their countries, could not but consider us as enemies. The peasants, tied to their fields and their cattle, remained in the countryside in a state of an outward obedience which in no way implied moral submission.  

Second, the French codified civil and commercial laws according to the French civil code model for Cochinchina in 1883, Tongkin in 1931, and Annam in 1939, but these codified laws also aim to preserve local customary laws and institutions. The Vietnamese scholar Nguyễn Văn Huyên observed:

“we can read in the report by the commission in charge of its elaboration [of the civil code 1931 for Tongkin] that the general spirit was not to encroach in any way on the fundamental institutions of Vietnamese society, while adapting them to the evolution of the customs and to the present social situation of the local people.”

In major cities in Vietnam, French cosmopolitan laws applied mainly to French nationals and foreign residents. French-style courts were set up in major cities to try cases involving the French, foreign residents who enjoyed special privileges like the French. These courts were largely not available to the indigenous people.

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91 Pham Diem, Vietnamese court system under the French rule (1999) 54 *Vietnam Law & Legal Forum* 27

92 Ibid
Third, the Vietnamese people had cultural feature of living with foreign invaders without losing their own way of life. This feature of the Vietnamese culture was severely tested against Chinese sinicization during one thousand year under the Chinese rule. During the French colonial century, French laws and commercial practices were shunned as the laws of invaders.\textsuperscript{94} 

In the same vein, it can be argued that the law of the pre-\textit{Doi Moi} era did not undermine the ‘merchant law’ based on basic Confucian morality. Indeed, as discussed in the previous chapter, legal principles drafted on the theoretical foundation of Marxist economic theory during the pre-\textit{Doi Moi} era aimed to protect a command economy and to outlaw free market exchange.\textsuperscript{95} The emergence of the ‘black market’, in which free bargaining took place, was largely the result of merchants hiding their contractual arrangements from the formal legal system.\textsuperscript{96} Although the decades of pre-\textit{Doi Moi} era might have influenced many aspects of the Vietnamese society, the market consistently opted out of the formal law of that time, for the sake of economic efficiency in market exchange.\textsuperscript{97} 

\textsuperscript{93} Ibid  

\textsuperscript{94} Pham Duy Nghia, \textit{Essentials of Vietnam's Business Law} (2001) at 23  

\textsuperscript{95} See Chapter 5.  

\textsuperscript{96} See Chapter 5  

\textsuperscript{97} Series of chronicles about economic reform during the pre-\textit{Doi Moi} era in \textit{Tuổi Trẻ} Newspaper recently recounts stories where not only merchants but also ordinary Vietnamese people and government officials opted out of the formal law to conduct market exchange during the command economy. See Đăng Phong, "Đêm trước' đổi mới: Imex - 'bầu sữa' của đột phá (trans: The night before Reform: Imex - the 'milk breast' for break through), \textit{Tuổi Trẻ} (Hồ Chí Minh), 12/12/2005 2005, ; Đăng Phong, "Đêm trước' đổi mới: từ chay gào đến phá cơ chế (trans: The night before Reform: from 'earn one's daily bread' to destroy the mechanism), \textit{Tuổi Trẻ} (Hồ Chí Minh), 7/12/2005 2005, ; Xuân
For all of these reasons, Confucian entrenchment for several centuries has deeply embedded its values in the social norms followed in modern times by Vietnamese people in their inter-personal relations, and in the social structures that have emerged to enforce social norms.

4. **MORAL NORMS OF RELATIONAL CONTRACTING**

Another reason why basic Confucian morality has had a sustained ordering effect within the Vietnamese market is the equivalence of functions of Confucian morality and modern contract law doctrines in supporting economic efficiency in contract relations. Indeed, some Confucian moral norms are comparable to modern contract law doctrines. The practical meaning of Confucian norms encouraged merchants to rely on them as default rules to fill gaps in contracts, therefore reducing bargaining costs as well as the risks of incomplete contracting. The next sections will compare some basic Confucian moral norms with modern contract law doctrines and discuss how these moral norms support economic efficiency in relational contracting in Vietnam.

Nhân means benevolence in the marketplace. It allows contracting parties to readjust contractual arrangements during *ex post* performance to achieve efficiency for the overall relationship. In the name of Nhân, the market may excuse a promisor of strict

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performance of contractual obligations, or limit the contractual liabilities of a promisor because market conditions have changed so unfavourably for him/her that strict performance may cause serious economic loss to him/her, or impede his/her ability to perform contractual obligations. In the name of nhân, a promisor can justify his/her request to renegotiate the price, or to readjust contractual positions because market change has made unequal the shares of costs, risks and benefit of the transaction. In the name of nhân, the market encourages a promisee to faithfully cooperate with a promisor during contract performance to overcome market adversaries, taking into consideration the other contracting party’s interests.

Nghĩa means righteousness and propriety or, more generally, conformity to one’s expected social role. Most popularly, nghĩa means loyalty and devotion in hierarchical relationships (king-mandarin, father-son, husband-wife, fraternal relationships, and good and sincere friendship). The practical meaning of nghĩa is that one should identify oneself with a social role from one of the five basic relationships and act accordingly. Confucius had this to say about nghĩa: "Duke Ching of Ch'i asked Confucius about government. Confucius answered, 'Let the ruler be a ruler, the subject a subject, the father a father, the son a son. . . ." (The Analects, XII:11). 98

A central principle of nghĩa is reciprocity, which is to say, do not do anything to others that you would not have them do to you. In the Analects, Tzu-Kung asked, 'Is there a single word which can be a guide to conduct throughout one's life?' Confucius said, 'It is perhaps the word ‘Shu’. Do not impose on others what you yourself do not desire'. 99 Reciprocity applies not only within the rationale of a one-off transaction, but

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98 For a recent edition, see Confucius, The Analects (1998 ed)

99 Ibid at XV:24
more popularly, to the whole on-going relationship between the two contracting
parties. The power of reciprocity to enforce relational norms, more particularly, tit-
for-tat strategies, was proved in Axelrod’s experiments. To interpret the norm of
reciprocity in the context of relational contracting, if one party compromises during
ex post execution of a business transaction due to the occurrence of an unexpected
contingency, he or she can expect the other contracting party to compromise in other
business transactions being conducted between themselves, either then or perhaps in
the future.

The practice of reciprocal compromise enhances contractual efficiency because it oils
renegotiation processes during ex post execution. It enables the contracting parties to
allocate the costs of an unanticipated contingency that arise during ex post execution,
to the most efficient cost-bearer, in a quick and cheap manner. Given the
consequences of ‘bounded rationality’ during ex ante contracting, that is, the limited
cognitive power of the contracting parties to predict what may happen during ex post
execution, the practice of reciprocal compromise reduces the high costs of attempting
to renegotiate and re-draft a complicated contract. In other words, the internalized
norm of reciprocity assures contracting parties that ‘gaps’ in the contract due to
‘bounded rationality’ are filled by parties practicing reciprocal compromise, arguably
the most efficient way to safeguard contractual efficiency should an unanticipated
contingency arise. The norm of renegotiation and reciprocity is therefore an implicit
code of conduct. The principle of reciprocity has its origin in social morals, explicit in
Vietnamese proverbs such as: gieo gió gặt bão (‘what you plant is what you harvest’,
or ‘as the call so the echo’) and có qua, có lai (‘give and take’).

Lễ has a variety of meanings, depending upon the context. It can mean propriety, reverence, courtesy or ritual but the popular and most widely-used meaning is conformity to the ideal standard of conduct. Lễ emphasizes the rights and duties which attach to social roles, or the roles that parties undertake in their relational contracts. Lễ encourages a promisor to accept contractual obligations as if they were obligations reflected in the social roles required of the quintessential Confucian gentleman.

Tín means trustworthiness. It is a Confucian ethical doctrine that is particularly practical to business relationships. Tín means building trust through keeping promises. Naturally, tín becomes the most important market norm for relational contracting. Tín encourages a promisor to bravely live up to his/her promises, following the personal virtue of ‘keep-working-on-it’. In the market, tín is believed to be the key controlling norm that regulates relational contracting among local merchants.101

Trung dung, the doctrine of the Golden Mean (Chung Yung), guides human conduct in their social intercourse with others. Trung refers to a state of equilibrium where passions are at peace, while dung means the proper, controlled reaction to external stimuli.102 Confucius said: ‘the superior man does what is proper to the station in which he is; he does not desire to go beyond this’. Trung dung – the doctrine of Golden Mean – can be loosely comparable to the Western contract law doctrine of fair

101 Van Tien, 'Luật thương mại bô roi người bán hàng rong (trans: Commercial Law 'forgot' peddlers)', VietNamNet (Hanoi), 8/5/2005 2005, (Members of the Parliament proposed to give legal effect to tin as a commercial practice in the new commercial law)

dealing. In the market, *trung dung* means being reasonable and tempers overexcitement at the prospect of high profits at the expense of the other party, in other words, ‘not going to extremes’. In contract relations, *trung dung* encourages parties to share costs and profits reasonably, rather than demanding the lion’s share of profits or avoiding the Shouldering of losses under a contract.

Loyalty is a fundamental virtue in Confucianism. This virtue derives from the concept of filial piety or loyalty and devotion to family members. The Hsiao Ching, a classic work on Confucian social practice, states that ‘[F]iliality is the foundation of virtue and the root of civilization. Begun in the service of our parents and continued in the service of the prince, filiality is completed in the building up of our character’. Confucius encouraged the doctrine of loyalty to be applied across a broader range of social relationships, as, according to his view, many social relationships can resemble filial relationships. When asked how the people could be made serious, loyal and enthusiastic, Confucius answered: ‘Preside over them with dignity and they will be serious. Be filial and kind and they will be loyal. Promote the good, instruct the unskilled, and they will be enthusiastic’. In a Confucian society, where ‘the father of the great world was the ruler, the ruler of the small world was the father’, personal loyalty (*trung*) is the essence of the ruler-subject, husband-wife, and friend-

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104 Hsiao Ching (1961) Chapter 1


friend relationships, and filial piety (hiếu), the essence of the father-son, elder brother-younger brother relationships. Nevertheless, a king, a father, or an elder brother is supposed to rule primarily by example, by cultivating and projecting the inner quality of virtue (duc) and not by promulgating an outer system of laws and institutions (phap). 107

In relational contracting, Confucian loyalty helps to solve the problem of moral hazards associated with principle-agent contracts, a popular category of contracts in the market. In traditional markets, where the state does not fiercely enforce property rights, merchants who engage in distant trade must rely on the loyalty of their agents who are vested with valuable assets. Because Confucian loyalty is the governing norm of filial relationships, the popularity of this concept is arguably responsible for the popularity of family business in Confucian markets, in which Confucian merchants tend to use kinsman in principle-agent transactions.

As is still the common practice now in many Asian countries following Confucian traditions, the extended family is probably the most important economic unit. As families and clans becomes intertwined by way of marriage, marriage becomes important not only for the continuation of the gene, but also for business purposes. Market exchange was probably conducted in the most part via family networks, which relied on Confucian loyalty to smooth transactions. Extended families also functioned as the firm, and family hierarchy was transformed into the operational structure of the firm. Loyalty was the norm to govern internal contracting in the family and to align individual interests of family members. Rituals (le) and righteousness (nghia) constituted the substance of loyalty or, in other terms, the corresponding obligations.

of the relationships. As the concept of family in a Confucian society can be easily extended to encompass all members of a clan, the doctrine of loyalty is naturally adopted as the governing norm for all kin relationships. Indeed, in a Confucian view, a family is a miniature society. How one learns to master one’s role in the family is also how one learns to deal with interpersonal relationships in the society at large.\(^{108}\) Therefore, the principles of conduct in filial relationships are also applicable in social relationships.

Harmony facilitates negotiation and conciliation while discouraging litigation or adversarial methods to resolve disputes. Harmony also facilitates flexibility in relational contracts. Specifically it encourages a promisee to compromise to a promisor’s request for re-adjustment of contractual terms during performance when the market turns out to be unfavourable to contract performance. Consequently, contracting is a form of human interaction that parties in Confucian-based societies do not approach in the way of ‘sharp in by clear contracting, sharp out by clear performance’\(^{109}\) but by balancing contractual efficiency considerations with the whole relational context, which normally has a history as well as an anticipated future. By weighing up the ‘give and take’ already enjoyed in a preceding relationship, as well as bearing in mind the importance of maintaining harmony for the health of the future relationship, contractual efficiency is seen merely as part of a whole, allowing parties to more easily compromise during ex post execution in

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108 The evidence is the popular maxim: ‘Tu than, te gia, tri quoc, binh thien ha’ (trans: Train oneself, manage one’s family, rule one’s country, pacify the world)

exchange for maintaining the harmony of the future relationship (which again promises reciprocal compromises in the allocation of benefits and losses).

Publications documenting the popular application of basic Confucian morality in business transactions in modern Vietnamese market places can be easily found in large bookstores in most big cities in Vietnam. In Hanoi, Ho Chi Minh City and Can Tho, publications of studies that apply Confucianism, Feng Shui and other dominant Oriental philosophies to business, can easily be found sitting side by side with books on business management published by Western business schools. Among the most popular titles of books that document the application of Oriental philosophies in business are ‘Ung dung Kinh-Dich trong kinh doanh’ (The application of the Book of Changes, (or I Ching) in business); ‘Ton-Tu-Binh-Phap trong kinh doanh’ (Sun Tzu’s military strategies applied in business); Khong-Tu (Confucius); and Manh-Tu (Mencius) to name a few, all published by local publishing houses. While these books are not generally available in the libraries of business schools in Australia, it is very popular in Vietnam for local merchants to claim belief in the practical value of applying these philosophies in business.110

5. FURTHER DISCUSSION

Historical and empirical records suggest a strong influence of basic Confucian morality on commercial practices in the Vietnamese market. However, it is necessary

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110 The influence of traditional Oriental beliefs in daily market exchange is supported by the fact that even surveyed merchants in Vietnam who have MBA degrees from Western-style business schools usually practice traditional Oriental beliefs in their daily business to supplement their knowledge of Western business management. For example, merchant 3 had an MBA from Maastrict University School of Business Management (the Netherlands). He runs a business consulting firm in Ho Chi Minh City in Vietnam. He said that he applies I Ching in his daily business as much as his MBA knowledge.
to repeat here that the institutional structure of Confucianism as a set of moral norms (rather than the sophisticated ideas of this class-distinct philosophy) gave this system of beliefs the ability to function to order inter-personal relationships, including contractual relationships, in traditional Vietnam. Comparability between basic Confucian norms and modern contract law doctrines in inducing efficiency in exchange relationships help explain the enduring effect of basic Confucian norms as an order of contractual arrangements in the Vietnamese market.

Given the existence of supra-contractual norms arising from the matrix of Confucian-style institutions in the market, a 'relational contract' in Vietnam should be defined to include not only the formal structure of rights and obligations prescribed in contract law and promulgated by the state, but also the informal structure of business morality derived from Confucian norms. The local concept of a 'contract' should be understood as an agreement enforceable not by the law alone, but by the institutional matrix of the market.

At this point, one may question whether the modern version of Confucianism in the Vietnamese market is actually a mix of Confucianism, Buddhism, indigenous norms and even Communism.\footnote{Shawn Frederick McHale, \textit{Print and power, Confucianism, Communism and Buddhism in the making of modern Vietnam} (2004)} This thesis does not defend the purity of Confucian norms as they are applied in contractual arrangements in the Vietnamese market. What this thesis concerns is the influence of Confucian morality on the ‘merchant law’ in the market, and differences between the ‘merchant law’ and formal contract law as a result of this influence. In fact, not only Confucian classics such as \textit{The Book of Changes (I Ching)} but also other Chinese classics such as \textit{The Art of War} by Sun Tzu...
are usually interpreted as business strategies in the Vietnamese market. This suggests a broad influence of traditional North Asian philosophies, rather than the pure influence of Confucian norms, in commercial practices in the Vietnamese market. However, as discussed earlier, Confucianism in the Vietnamese market is not an abstract philosophy, but a set of basic moral norms that govern daily inter-personal relationships. In the absence of state-run institutions to support market exchange in the traditional and modern Vietnamese market, the popularity of basic Confucian morality (irrespective whether it is a Vietnamese mixed version of Confucianism, Buddhism and Communism or a pure Chinese version of Confucian classics) can offer a convenient order for business people to coordinate expectations in their daily contractual arrangements.

How do these findings fit into the argument structure of my thesis? First, this chapter confirms the institutional hypothesis of relational contracting. The practice of relational contracting in Vietnam market has its roots in social institutions, and institutional changes in contemporary history. Second, this chapter maps out a significant feature of the institutional matrix of the market. Confucian-derived morality arguably provides basic norms for market institutions that govern relational contracting. Accordingly, this chapter suggests that the supra-contract norms that merchants follow in relational contracting arguably feature basic Confucian morality.

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112 One can easily find books writing on the application of *The Book of Changes* or *The Art of War* in business contexts in popular book stores in Ho Chi Minh City
CHAPTER 7 – ENFORCING THE MERCHANT LAW IN MODERN VIETNAMESE MARKET

1. THE ORDERING POWER OF INSTITUTIONAL STRUCTURES

The previous chapter investigated the existence of a ‘merchant law’ in the Vietnamese market. It argued that this ‘merchant law’ features basic Confucian morality, and shapes the relational contract behavior of local merchants. The description of the private ordering system in the previous chapter is, however, not yet complete.

According to Douglass North, for an institution to order social relationships in a social group, there must be two elements: norms and enforcement mechanisms. ¹ As a qualification to North’s understanding of norms, members of the social group must have a common understanding about what the norms mean. If the norms convey different meanings to different members of the social group, they cannot coordinate expectations of members of the social group in their social affairs, such as market exchange. Even if norms convey similar understandings among members of the social group, there still need to be incentive structures to induce compliance with norms.

A norm by definition is a constraint that would impose a cost upon the subject, being the difference between the utility of complying with the constraint in the circumstances and the utility of achieving the best outcome in the circumstance given the absence of the constraint. Without enforcement mechanisms, members of the social group may feel free to breach the norm whenever it is in their individual interests to breach.

¹ Douglass C. North, Institutions, Institutional Change, and Economic Performance (1990)
So, for example, Robert C. Ellickson when verifying the existence of a private ordering system among ranchers in Shasta County in northern California, the United States concluded that:

> [t]he fact that many of the people interviewed said that a good neighbor would supervise his livestock was only weak evidence of this norm [that an owner of livestock is responsible for the conduct of his animals]. That most of them did mind their animals said only a little more. The best evidence that this norm existed was that Shasta County residents regularly punished, with gossip and ultimately with violent self-help, ranchers who failed to control their cattle.²

However, Ellickson proposed that members of a social group painstakingly develop norms for themselves to maximize welfare from their interaction.³ I do not concur with this proposition. For merchants, who try to economize on transaction costs of contract governance, developing wealth maximizing norms for each contractual relationship can be prohibitively costly. Moreover, norms need incentive structures to induce compliance with them. Therefore, it is much less costly for them to construct their relational norms in compliance with default norms of existing relational institutions so that they can rely on these institutions to enforce their relational norms.

The question that is investigated in this chapter is how the market enforces the ‘merchant law’, without the help of the state. This chapter proposes that there are social structures in the Vietnamese market that function as enforcement mechanisms for the ‘merchant law’. Both the ‘merchant law’ and market enforcement mechanisms constitute the informal ordering system for relational contracting in the market, which function in parallel with the formal contract law system. Accordingly, this chapter


³ Ibid
investigates which social structures may function as these enforcement mechanisms, and how they actually do function.

Informal institutions can be categorized according to three groups of extralegal incentive structures that enforce relational norms of contracting. The first is the selection of clients on the basis of internalized norms that comply with relational norms of the market. The second is retaliation, or the recourse to bilateral sanctions. The third is the recourse to group sanctions generated by business networks or loss of reputation in the market.

In this section, I examine some of the market incentive mechanisms that enforce relational norms of the ‘law merchant’ in Vietnam that I observed to exert the most influence upon the contract practice of local merchants; market selection, long-term bilateral relationships, private sanctions, and business networks. These social structures of the market reflect the incentive structures mentioned above.

2. **SELECTING CLIENTS**

As demonstrated in McMillan and Woodruff’s survey and my own, it is a popular practice in Vietnamese market for merchants to carefully select clients as their main strategy of contract governance. Selecting clients is a market mechanism that enforces market norms in relational contracting by inducing merchants to internalize the norms

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4 Douglass C. North, *Institutions, Institutional Change, and Economic Performance* (1990) at 33 (‘Enforcement can come from second-party retaliation. It also can result from internally enforced codes of conduct or by societal sanctions or a coercive third party (the state)’)

5 Ibid

6 Ibid
of the market. The functioning of this market mechanism is supported by extensive informational networks in the market that allow merchants to select low-risk partners.

All merchants that I interviewed in Vietnam select clients carefully to reduce risks in long-term contracting. In response to my question: 'Do you carefully pick your clients, and why?', the unanimous answer was: 'Yes, to avoid risks'\(^7\) hence if my sample was representative it could be concluded that selecting clients is one of the key governance structures used to reduce transaction costs of contracting in this market.

Merchants generally select clients based on \(\text{chữ tín}\).\(^8\) \(\text{Chữ tín}\), as noted, may be roughly translated as ‘trust’ in English. Nevertheless, the local meaning of \(\text{chữ tín}\), especially when local merchants interpret chu-tin in specific local contexts to govern their relationships, may differ significantly from the word ‘trust’ in English-speaking societies, as discussed further below.

My research investigated the basis upon which merchants selected their clients. I put to each interviewee five possible criteria for the selection of clients which may function as non-court governance structures that enforce promises in relational contracting. I asked each interviewee to indicate which if any of the criteria most strongly reflected the basis upon which they selected their clients:\(^9\)

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\(^7\) See also John McMillan and Christopher Woodruff, 'Interim Relationships and Informal Credit in Vietnam' (1999) 114 Quarterly Journal of Economics 1285 at 1287 (A surveyed local merchant said the amount of credit he granted to a client depends on the reliability of the client, evaluated by visiting his shop)

\(^8\) Merchant 28

\(^9\) See Appendix
1. The client can procure a bank guarantee for the transaction. This criteria functions as a bond or hostage;

2. The client has good reputation for chử tín in the market. This criteria corresponds with the concept of reputational sanction;

3. The client possesses valuable assets of high liquidity. Again, this corresponding with the use of hostage;

4. The client has prospective repeated transactions. This criteria corresponds to protection afforded by relation-specific investment and ‘tit-for-tat’ sanctions; and

5. The client is within the merchant’s close-knit rings (close contact circle, kinship, in the same ethnic or regional community group, classmate…). This criteria also relies upon the standard repeated-game story of conducting business in the context of long-term relationships.

From these five selection criteria, local merchants unanimously picked chử tín as one of their preferred criteria for selecting new business clients.10

So what do merchants mean by chử tín? The term derives from tín, a key concept underlying Confucian morality. In simple terms chử tín can be understood to mean keeping promises. But for many local merchants, this concept is also a philosophy of

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10 100 percent of local merchants pick chu-tin as one of their preferred criterion for selecting clients. The second most-preferred criterion was prospective repeated transactions. For non-court assurance methods, see, for example, D. Charny, 'Nonlegal Sanctions in Commercial Relationships' (1990) 104(2) Harvard Law Review 373 <<Go to ISI>://A1990EN19400001 >
business conduct. One businesswoman in Can Tho went to lengths to write down her interpretation of what chu-tin means:

*Chu-tin* in business is known as a set of basic norms that business people use to determine the extent to which they can cooperate or undertake business transactions with a business entity. This set of norms is generally termed as the ‘trustability’ of one merchant on the basis of valued personal qualities in business such as honesty, faithfulness and creditability. It is universally believed that these qualities are an efficient instrument for conducting business deals. This conception, in practice, is so universal that people take it for granted and enforce it subconsciously. *Chu-tin* is used as a fundamental criterion for a decision of business transaction on any scale although the manifestations of the *chu-tin* concept may vary under different circumstances.

Another description of *chữ tín* derives from Barton’s study of ethnic Chinese businessmen in Vietnam (who use the term *sun yung* for *chữ tín*) as follows.

In a community totally oriented toward business transactions, *sun yung* was the most important aspect of a person’s character and not merely a quality to be considered in economic affairs. *Sun yung* referred not only to credit, in the sense of goods or services lent without immediate return against the promise of a future repayment or to ‘credit rating’, which is an assessment made by a lender of the risks involved in extending credit to a specific individual; it further carried the connotation of a person’s total reputation for trustworthiness and in that sense was a statement of a person’s social and psychological characteristics, as well as strict economic reliability.

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11 Hả Dằng, 'Chữ tín là 'đạo' của kinh doanh (trans: Chu-Tin is the faith in business)', *Tuoi Tre* (Ho Chi Minh City), 9/10/2004

12 In-depth interview with a member of the Chinese business community in Ho Chi Minh City.

Western scholars have tended to interpret "chữ tín" simply as meaning to keep promises, however the interpretations of "chữ tín" in the Vietnamese market go beyond merely expecting merchants to keep their promises in business dealings. "Chữ tín" also conveys heavy expectations regarding the social roles of merchants, quite aside from their business deals. These interpretations add support to my argument in Chapter 3 that social and business relationships are inseparable in the Vietnamese market. In accordance with its fulsome and more accurate meaning, "chữ tín" helps local merchants to coordinate their expectations in their efforts to plan exchange into the future and to carry out that exchange. "Chữ tín" appear to be the key basis upon which merchants select their business partners.

Besides selecting clients based on the basis of their "chu-tín", different views regarding other transactional governance structures emerged from the interviews conducted. Merchant 10, who manufactured aluminum kitchen wares, said she developed her company from a small family business by devoting their business to developing long-term relationships with agents and wholesalers of her products in the Mekong Delta markets. She described these relationships as if they were among family members: 'very close, supportive, and trusted'. Merchant 28, who sold garments and textile materials and equipment, however, had a different view of long-term relationships: 'Although they said five years [of repeated contracts], but I must come and see their factory. Who knows, they may not operate their business efficiently and may close down suddenly'. He said he followed the old saying: 'An cay nao rao cay ay' (fence

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14 Recall that in Chapter 3, several surveyed merchants said they investigated not only financial capacity but also internalized norms of potential business partners before proceeding with business deals. These empirical data confirms the interpretations of ‘chu-tín’ as a set of internalized moral norms, rather than the mere keeping of promises.
the tree from which you pick fruits), which means that the expected repeated
exchange in long-term relationships should not induce him to enter transactions that
are not obviously profitable. Inconsistent with the common assumption that the family
business tradition in Southeast Asia prefers clients from family circles, this kind of
client was, in fact, not popular in my sample.\textsuperscript{15} Seeking a guarantee from financial
institutions is also not popular among surveyed merchants from the private sector.
However, nearly half of surveyed merchants running state-owned enterprises said
they preferred clients with valuable assets of high liquidity.

For the purpose of selecting clients, merchants continually collect private information
about their prospective clients. High-risk clients arguably do not want to reveal
truthful information about their true level of risk for fear of loosing exchange
opportunities.\textsuperscript{16} Local merchants therefore try to collect all information they can
about an individual client.\textsuperscript{17} Very sensitive and private information such as whether a
client has children out-of-wedlock can also be useful for assessing the client’s

\textsuperscript{15} Janet T. Landa, ’A Theory of the Ethnically Homogeneous Middlemen Group: An Institutional
Alternative to Contract Law’ (1981) 10(2) Journal of Legal Studies 349 (suggesting that Chinese-ethnic
merchants in Southeast Asia prefer clients from familiar circles). None of my interviewees said they
prefer clients from their family circles. In my observation, this sort of client is not attractive because it
offers limited business opportunities, given the small business sector in transitional Vietnamese market
economy. See my analysis of market development in contemporary Vietnam in Chapter 6

\textsuperscript{16} In the contract law literature, this is called the adversarial problem or the moral hazard problem.
Oliver E. Williamson, The Economic Institutions Of Capitalism (1985)

\textsuperscript{17} In-depth interview with merchant 28. See also John McMillan and Christopher Woodruff, 'Interim
1287 (Surveyed merchants said they yield information about clients' creditworthiness through direct
dealings)
credibility for long-term contracting.\textsuperscript{18} Private information about clients can be collected in many different ways. An importer and distributor of products for the textile and garment industry in Ho Chi Minh City said: ‘I collect and analyze information about [my clients’] business contacts. This information would reveal whether that client has serious business…’.\textsuperscript{19} A manufacturer of kitchenware with an extensive network of agents and wholesalers in the Mekong Delta provinces collects information about her business partners from their competitors. She said that when she suspects an agent or a wholesaler may not be trustworthy, she will go quietly to the client’s market and chat with the client’s competitors in the market to extract private information about the client’s financial status. ‘Because they are competitors, after a few conversations, they would tell me all about the troubles that client has, and that’s what I want to know’, she said.\textsuperscript{20} For a trader of fertilizers and agricultural machinery in Vinh Long province, private information about clients mainly comes from his various social drinking groups.\textsuperscript{21}

Merchants not only need information to select new clients, they also need private information about existing clients to adjust their ongoing relationships to prevent opportunistic behaviours. Carefully monitoring a client’s opportunistic incentives, and quickly balancing these incentives by adjusting the advances is a popular way to avoid the problem of opportunism in incomplete contracting. A surveyed merchant monitored clients by comparing his invoice issued to clients and the client’s

\textsuperscript{18} Merchant 9

\textsuperscript{19} Merchant 28

\textsuperscript{20} Merchant 10

\textsuperscript{21} Merchant 9
payments: ‘My method is very simple: I check the temperature everyday, like doctors monitoring their patients. I think there is no other way to avoid the risk’.

If a client always meets payment due, he gradually increases the volume of transactions with that client. If the client fails to meet payments, he would turn to cash-based transactions.

All surveyed merchants gradually increase the volume of exchange with a client as the level of trust increased, and quickly withdraw advances when there is some suspicious information about the client. This contract governance strategy requires continually updated information about each client and market factors that may influence the client’s financial situation. Through their unceasing efforts to update information about clients and markets, local merchants, in fact, form information channels by acquiring strategic membership in social groups and being active in networking activities. These networking activities, pursued by all local merchants as part of their daily business, ensure that information flows well in the market. In a market where information channels are well established, a merchant who contemplates opportunistic breach of promise faces the serious threat that all advances and credits would instantly become due if adverse information about them spreads in the market.

State-owned enterprises appear to be treated differently from private enterprise due to their status. State-owned enterprises are fully or partly funded by the state budget.

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22 Merchant 28

23 Merchants 28, 5

State-run commercial banks usually back state-owned enterprises. Therefore state-owned enterprises may not be easily bankrupted. However, collecting debts from state-owned enterprises can be difficult, given the common assumption that the judicial system is biased favorably toward public interests. Therefore, careful monitoring and quick adjustment of advances are still the most effective method to reduce transactional risks. As merchant 28 put it, he would still ‘listen carefully’ (nghe ngong) for information about his state-owned enterprise clients in the market, and ‘not satisfy all of their offers…’ [that is, he does not give credit easily to state-owned enterprise clients without being confident as to the state-owned enterprise’s credibility].

Popular group activities such as social drinking and eating groups, tennis, golf or entertainment groups facilitate economic exchange because through them merchants can learn about their client’s true risk level in term of internalized norms, which may not be apparent in the formal business context.

Person-to-person contact is the preferable method for judging a new client. Face-to-face meetings with a new client are usually insisted upon. ‘Wining and dining’ play a huge role in building business relationships. A surveyed merchant said he met his clients and entered deals in restaurants more often than in their offices. Local merchants normally prefer face-to-face meeting with new business partners so that they can intuitively judge the clients’ internalized norms through their appearance and

25 Merchant 28

26 This is one of the reasons explaining the large number of restaurants, tennis courts, and places for entertainment in Ho Chi Minh City.

27 Travel books on Vietnam such as Mason Florence and Robert Storey, *Lonely Planet - Vietnam* (6 ed, 2001) at 114 noted that ‘restaurants of one sort or another seem to be in every nook and cranny’.

28 Merchant 20
conduct. This practice requires face-to-face contact between the merchant and the client.

Drinking is a popular way to judge clients amongst old-fashioned merchants. Most merchants who drink agree that drinking together is a good way to judge the personality of a client before doing business with them because it is believed that when a person is drunk, his or her true personality is revealed.

At different levels of consciousness, many local merchants still rely on phrenology – the art of guessing personality by the shape of the head – as a traditional screening method to select low-risk clients.

All of the surveyed merchants procured most of their clients through business networks. One exception was merchant 6, who found his current most important buyer using the Internet. His company manufactures bullet nails for nail guns used in the construction industry. As nail guns are still too expensive for the local

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29 Merchants 4,5,6,7,8,9. As the market develops in Vietnamese market, local newspapers recently reported a trend among merchants in Ho Chi Minh City that, according to an old belief in the link between astrology and business, both male and female merchants in Ho Chi Minh City now increasingly frequent beauty salons for cosmetic surgery to make their appearance more astrologically pleasing to attract more clients and improve business success. See 'Sửa tướng để làm giàu (trans: Cosmetic surgery improves business success)', Vnexpress (Ho Chi Minh City), 16/10/2004 2004,

30 See also John McMillan and Christopher Woodruff, 'Interim Relationships and Informal Credit in Vietnam' (1999) 114 Quarterly Journal of Economics 1285 at 1287 (one Vietnamese merchant interviewed said that he visited his clients regularly to investigate their 'financial capability and personality') [emphasized]

31 Merchant 9. I found a similar practice of selecting clients in Cambodia. In Cambodia, restaurants often print on their menus in the drink section the title 'Drink For Getting Drunk' [sic] instead of a simple 'Drinks', which suggest the common practice of their clients when they go together to restaurants for business meals.
construction industry, which uses more manual methods, he sought importers from Taiwan and other developed countries. His largest importer is from the United States, whom he contacted via email and has never met in person. Merchant 25, the owner and director of a logistics company in Ho Chi Minh City, estimated that expenses associated with maintaining her business network accounted for thirty percent of her business costs.

The ethnic Chinese Vietnamese generally prefer doing business with clients from the same congregations or dialect groups.\textsuperscript{32} ‘Chi ky danh’ (our people) was the term used by the Cantonese ethnic merchants when referring to other Chinese merchants who belong to their Cantonese group, which usually meant that a higher degree of trust was extended for economic exchange.\textsuperscript{33}

The indigenous Vietnamese entrepreneurs that I observed also relied to a great extent upon business networks of friends and old clients to seek clients, although business networks within family members and relatives are not as extensive and tight-knit as amongst ethnic Chinese Vietnamese congregations.

For the smooth functioning of the market, networking and sharing private information about clients becomes a well-established relational norm. Merchant 10, who manufactures aluminum kitchen wares in Can Tho, was expecting a friend from Ho Chi Minh City when I conducted the interview. That friend was also a manufacturer of stainless steel home décor and kitchen wares in Ho Chi Minh City. He went to Can Tho to investigate one important agent of his products in the Mekong Delta. He

\textsuperscript{32} Merchants 6,8,9.

\textsuperscript{33} Interview with a Chinese ethnic merchant.
stayed with the interviewed merchant for a few days to collect information about his agent.

Another manufacturer of plastic products in Can Tho once came to visit her and asked for private information about a wholesaler who was buying from her business, but who had just started a business relationship with the competitor. She treated her competitor in a very friendly way and revealed private information about the client that she had accumulated.34

Another merchant in Can Tho, who is the chairman of a joint-venture manufacturing nails for export, told an interesting story of how merchants voluntarily share information about clients. In that joint-venture, shareholders were local merchants and one partner from Taiwan. When the joint-venture started to make profit, the Taiwanese partner quietly planned a ‘coup d’etat’ to take over the business. The local merchants did not know about the plot until one day, a businessman in Taiwan who knew the Taiwanese partner in the joint-venture called the chairman, and told him about the plot. According to the chairman, he had never met the businessman in Taiwan who helped him save his business from the Taiwanese partner. The businessman in Taiwan simply found his name and telephone number in the company’s booklet. The Taiwanese businessman’s motive was simply to help another merchant in accordance with relational norms; he did not want the cheater to do ‘a bad thing’ against established business norms that he has internalized as moral norms.35

34 Merchant 10.

35 Merchant 6. In this interview, I was not told in details of the arrangements of property rights in the joint-venture that exposed merchant 6 to the risk of his Taiwanese business trading partner capturing
The practice of selecting clients based on *chu-tin* creates a market institution that reduces uncertainty of incomplete contracting and prevents opportunistic behavior. *Chu-tin* is a basic concept that conveys basic relational norms to facilitate adjustment in incomplete contracting. When interpreted in light of daily business transactions or under broader doctrines such as the Golden Mean doctrine and other basic norms of Confucian morality, *chu-tin* promotes the values of cooperativeness, risk-and-profit sharing, and loyalty to the relationship, that is, not to behave opportunistically when unanticipated contingencies arise.

In addition, market selection of clients based on the relational norms they follow results in merchants naturally internalizing those norms in order to increase their business opportunities. In this market, the relational norms expected are derived from the basic concept of *chu-tin*. Because there are existing channels in the market that effectively disperse private information about merchants, those who behave badly do not survive the selection process and are compelled to leave the market. A bad merchant chooses to behave opportunistically only if opportunistic gain outweighs the cost of lost business opportunities.

The practice of selecting clients based on *chu-tin* may lock contracting parties into a long-term relationship. Investment in efforts to select a client who has internalized

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his property rights in the joint-venture. However, information I obtained during the interview suggests that arrangements of property rights within parties in the joint-venture were highly relational, instead of legal. This is consistent with the relational practice in the Vietnamese market, particularly in the business community of Chinese ethnic merchants in Vietnam. See, for example, Clifton Barton, 'Trust and credit: some observations regarding business strategies of Overseas Chinese traders in Vietnam' in Linda Y.L Lim and L.A.P Gosling (eds), *The Chinese in Southeast Asia: Volume 1, Ethnicity and Economic Activities* (1983)

36 See Chapter 5
appropriate norms becomes a relationship-specific investment, which will be forfeited if the relationship terminates, or exchange is not repeated.\textsuperscript{37} The costs of searching for substitute clients or the inherent risks of doing business with a new client whose norms are not yet tested may discourage merchants from escaping existing relationships.\textsuperscript{38} A merchant who terminates a relationship with a good client without cause may also damage his or her reputation in the market and discourage potential clients. Merchants may also encourage their business partners to reveal sensitive and/or private information about themselves, such as personal affairs, as a demonstration of their commitment to a long-term relationship.\textsuperscript{39}

3. \textbf{LONG-TERM RELATIONSHIPS}

Using repeated dealings to prevent and resolve disputes has been discussed in detail in McMillan and Woodruff’s study of trading relationships in Vietnam. McMillan and

\textsuperscript{37} Oliver E. Williamson, \textit{The Economic Institutions Of Capitalism} (1985) at 72-5 (Discussing transaction-specific economies, the value of which will be lost if the transaction is forfeited. Similarly, investment in a relationship creates transaction-specific economies, the value of which will be forfeited when the relationship terminates, or reduced in value if the relationship is not used to support exchange, the primary purpose of the relationship)

\textsuperscript{38} Also mentioned in John McMillan and Christopher Woodruff, 'Interim Relationships and Informal Credit in Vietnam' (1999) 114 \textit{Quarterly Journal of Economics} 1285 at 1286 (‘Our main findings are that trade credit tends to be offered when (a) it is difficult for the customer to find an alternative supplier; (b) the supplier has information about the customer's reliability through either prior investigation or experience in dealing with it…’)

\textsuperscript{39} Merchant 9 in Cantho, for example, said that whenever he went to Ho Chi Minh City to see his clients, or when his clients came to Cantho, they went out drinking together. This drinking practice not only served the purpose of exchanging information about the market or negotiating deals, but also drinking until drunk together was seen as a commitment into a long-term relationship because it reveals not only strength but also weaknesses.)
Woodruff concluded that the role of long-term relationships in preventing disputes is as follows:

[t]he decision to cooperate rests on a comparison between the immediate gains from cheating and the discounted future losses. A workable governance structure either gives an immediate incentive to live up to the agreement regardless of any future sanctions, or at least reduces the gains from cheating below the costs in loss of future business.\textsuperscript{40}

However, McMillan and Woodruff did not attempt to explain a critical issue raised by the standard repeated-game theory: how is it that merchants calculate the ‘discount factor’ (in the jargon of game theory) of their partners.

How one assesses the ‘discount factor’ of a business partner is very much a matter of business experience. However, there are some obvious indicators which may assist in conducting the assessment, such as a valuation of the business partner’s history in the same business (for example, older businesses often indicate the year of their establishment as an indication of reliability and commitment). Checking the record of the business partner in his or her dealings with others may indicate if he/she values long-term relationships. As explored earlier, the collection of private information about the business strategies or other matters concerning the potential partner is also a common assessment tool.

Another factor that affects the decision to cooperate is the availability of other options.\textsuperscript{41} The availability of other options may indicate the degree to which the business partner will be willing to remain committed to the relationship, or at what point he or she may want to terminate the relationship and seek recourse to other options.\textsuperscript{42}

Long-term relationship building is key to resolving most commercial disputes in Vietnam. Interviewees stressed the importance of long-term business relationships for financial stability\textsuperscript{43} or stability of material supplies.\textsuperscript{44} The manufacturer of paints and construction powder said that long-term relationships make it easier for parties to concede when disputes arise, because both sides look forward to long-term interests.

Incrementally locking a client into a business relationship by gradually increasing credits, is the most popular method of creating relation-specific investment.\textsuperscript{45} One example of this is the way that manufacturers commonly grant credits to agents and

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\textsuperscript{41} A detailed discussion of the role of other options in business negotiation contexts can be found in Roger Fisher, William Ury and Bruce Patton, \textit{Getting to yes: negotiating an agreement without giving in} (2nd ed, 1997) (using the term Best Alternative To A Negotiated Agreement, or BATNA, to denote outside options)

\textsuperscript{42} Ibid

\textsuperscript{43} Merchant 2

\textsuperscript{44} Merchant 1

\textsuperscript{45} Using informal credits to build relationship has also been discussed in John McMillan and Christopher Woodruff, 'Interim Relationships and Informal Credit in Vietnam' (1999) 114 \textit{Quarterly Journal of Economics} 1285
wholesalers.\textsuperscript{46} The manufacturer gives the wholesalers credits in the form of deferred payment for the shipment. The wholesalers pay for the first shipment when the second shipment arrives.\textsuperscript{47} The value of credits granted is proportionate to the level of trust, which must be gradually built upon during the course of repeated business interactions.\textsuperscript{48}

\section*{4. PRIVATE POWER}

Political science has long been concerned with private institutions that can capture state power to enforce private ‘rules of the game’ for individual interests. Scott (1969) observed two main ways that private institutions do this: ‘pressure-group politics’ or the capturing of state power by influencing legislation before it is passed; and ‘corruption’, or the capturing of state power by influencing the enforcement of legislation.\textsuperscript{49} Scott, however, carefully notes that: ‘while not all corruption occurs at the enforcement stage and not all ‘influence at the enforcement stage’ is corrupt, as the empirical referents of the two terms overlap considerably. A striking example, of

\begin{footnotesize}
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\item \textsuperscript{46} Agents are usually wholesalers who commit to sell an agreed quantity of the product in a period of time. Agents do not have to pay for the shipment, but earn commissions on the quantity sold. Wholesalers buy products from the manufacturer to re-sell the products to retailers
\item \textsuperscript{47} Interview with Merchant 10 in the industry of kitchenware and home appliances in Can Tho. This practice is more established in Can Tho and other Mekong Delta regions than in economic centers such as Ho Chi Minh City or Ha Noi, where banking services are more popular.
\item \textsuperscript{48} In-depth interview with merchant 10
\item \textsuperscript{49} James C. Scott, 'Corruption, Machine Politics, and Political Change' (1969) 63(4) \textit{American Political Science Review} 1142
\end{itemize}
\end{footnotesize}
course, is the legitimate arena of ‘regulatory politics’ that largely involves contending interpretations of status governing private sector activity’.  

Lim and Stern’s review of the political economic literature on Southeast Asia suggests that political patronage and clientelism capture the state’s power and function as the main ordering system in these markets.  

Bardsley and Nguyen’s analysis of rent-seeking in litigation under weak judicial systems suggests that politically well-connected litigants can capture judicial power to tilt the bargaining table their way and force the other party to accept their own norms.  

Milhaupt and West’s study of private ordering in Japan found that criminal gangs play an important role in enforcing the transfer of property rights in Japan, and the legal system has been tolerant of this breed of private power.  

In this section, I use the term ‘private power’ to refer to the situation a merchant can capture the state power and use the state power to enforce his or her own business norms in his or her business relationship with others. I attempt to explore how private power is used in contract governance in the Vietnamese market.

During my field trips, I asked merchants in Vietnam and Vietnamese merchants in Phnom Penh (Cambodia) if they maintain relationships with politicians, law

50 Ibid

51 Linda Y.C Lim and Aaron Stern, 'State power and private profit: the political economy of corruption in Southeast Asia' (2002) 16(2) Asian - Pacific Economic Literature 18

52 Peter Bardsley and Quan Nguyen, 'Rent-seeking and Judicial Bias in Weak Legal Systems' (Working Paper, University of Melbourne Economics Department and Law School, 2004)

enforcement officials or members of the court for the purpose of enforcing promises; if so, whether they ever use these patron-client relationships to enforce promises; or if they know of other merchants who use their patron-client relationships to enforce promises.

None of the surveyed merchants in Vietnamese market said that they maintain patron-client relationships. Nor did any of them admit to ever using patron-client relationships to enforce promises. One merchant running an industrial park in Can Tho said he was aware of other merchants who used political connections to solve business disputes, but could, or would not recall the details, probably because he did not want to discuss it.54

In Cambodia, on the other hand, all surveyed merchants said that seeking powerful patrons is a popular and necessary practice to further business in the market. Local merchants who procured patronage did not hesitate to signal to the market that they were well connected to powerful patrons in the government and the military, as part of their business strategy.55

If merchants actually possess private power to enforce inter-personal norms in business transactions, it is usually better for them to signal their power in the market, rather than actually use that power.56 Compared with the open and receptive attitude

54 Merchant 29,

55 One exception is merchant 15, who said that her perseverance was her only weapon to compete with other merchants who had powerful patrons.

56 In a market where the use of patrons to enforce promises is a common knowledge, it is cheaper for a merchant empowered by a patron to signal his power in the market than actually use this power to enforce promises, which usually entails costs of mobilizing the patron and defending such a use before
of merchants in Cambodia to the practice of using patronage power to enforce interpersonal norms, my research indicates that the use of patronage to enforce promises is not popular in the Vietnamese market. One possible explanation is that the state and its institutions in Cambodia are still weaker than those in Vietnam. It may therefore be cheaper and more effective for merchants in Cambodia to use private power in the form of patronage to navigate the institutional matrix of the market than it is in Vietnamese market.

Although surveyed merchants in the Vietnamese market were very reluctant to admit the use of patronage in enforcing promises, even in the context of a confidential survey, this does not mean that private power does not exist in this market. Sophisticated means of capturing state power in the Vietnamese market have sometimes been reported in local news. The most extreme example of the phenomenon of private power in contracting is the ‘criminalization of civil disputes’, where a police officer, a prosecutor, or a judge attempts to apply criminal procedure to the resolution of a civil dispute in an effort to extract some concession from the ‘suspect’. This situation usually involves a well-connected merchant who mobilizes his or her patrons in the police, the prosecution bureau or the court to threaten criminal sanctions against another merchant in order to enforce private norms.

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57 In 2004, the Ministry of Justice and the Ministry of Police held a conference to raise their concern about this social issue and to discuss solution. See Lao Độ and Thanh Niên, 'Tìm cách giải quyết việc hình sự hóa các quan hệ dân sự (trans: find ways to prevent the criminalization of civil disputes)', VNEpress (Hanoi), 14/1/2004 2004,
Another method used to capture state power in Vietnam is where local police receive bribes to turn a ‘blind eye’ to a powerful local merchant who uses criminals to threaten or actually inflict physical damages upon other local merchants in order to enforce private norms. The Phap Luat (trans: The Law) newspaper in Ho Chi Minh city in 2004 reported a series of investigations by journalists into a local criminal gang in Phan Thiet. The gang was led by a merchant known as Minh Samasa, who attacked and injured local merchants in the fishery industry to secure his monopoly position in the local market. Some local police were reportedly involved in the gang.8

More recently, the Thanh Nien (trans: The Youth) newspaper reported a series of investigations by journalists into a criminal gang in Binh Thuan province.9 Hai Chi, a powerful merchant in the logging industry in Binh Thuan province, used criminals to enforce his ‘law’ and to secure a monopoly in the logging industry in the province for several years.10 The head of the provincial police and many local policemen were reportedly behind the gang covering up the gang’s crimes against local merchants. Again, journalistic investigation unveiled the gang’s activities, leading to the arrest of Hai Chi and the local police chief by members of the police force from the Ministry of Interior.

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10 Ibid
In other cases, the capture of state power may not be limited to the patron-client relationship between powerful local merchants and the local police, but may reach high level politicians and police officers. The ‘Nam Cam’ trial is a case of state capture that shook the nation in 2003.\textsuperscript{61} Nam Cam, a ‘godfather’ of casinos in Ho Chi Minh city, was able to count a deputy minister of the Ministry of Interior and a deputy chief of the Prosecution Bureau among his patrons.\textsuperscript{62}

In other institutional environments, private sanctions may involve even more blatant forms of state capture.\textsuperscript{63} One surveyed Vietnamese business woman who runs a supermarket in Phnom Penh faced fierce competition from local merchants. One competitor paid local newspapers to attack her because of her Vietnamese origin drumming up racism among local people. Not satisfied with this, the competitor went even further and paid the police to imprison her for one week. The Vietnamese business woman then had to pay the police to buy back her freedom.\textsuperscript{64}

\textsuperscript{61} For English language writing on the Nam Cam case, see Kerstin Steiner and Nguyen Hung Quang, 'Ideology and Professionalism: The Resurgence of the Vietnamese Bar' in John Gillespie and Pip Nicholson (eds), \textit{Asian Socialism and Legal Change: The Dynamics of Vietnamese and Chinese Reform} (2005)

\textsuperscript{62} Anh Thür, 'Nguyễn Thập Nhất: 'Tự do là điều đáng giá nhất' (trans: Nguyen Thap Nhat: 'Freedom is the most valued'), \textit{VNExpress} (Hanoi), 1/2/2005 2005, ; Anh Thür, 'Nguyên thứ trưởng Bùi Quốc Huy được đặc xá (trans: former deputy minister Bui Quoc Huy granted amnesty)', \textit{VNExpress} (Hanoi), 31/1/2005 2005, ; Hoài Thương, 'Trần Văn Thuyết: 'Quan hệ với quan chức đều là tình cảm' (trans: Tran Van Thuyet: Contacts with government officials were purely for the sake of friendship)', \textit{VNExpress} (Ho Chi Minh City), 10/09/2003 2003,

\textsuperscript{63} Merchants 11,12,13,14,15,16

\textsuperscript{64} Merchant 14
Another surveyed Vietnamese merchant experienced a tax raid on his warehouse near Phnom Penh. Although it later emerged that the tax officials had raided the wrong address and upon realizing their mistake, moved on to the next warehouse, the merchant learned that the tax raid was the result of a business dispute between two local merchants, one of whom had mobilized patrons in the tax office to raid the competitor’s warehouse.\(^{65}\)

A subject of gossip among Vietnamese merchants in Phnom Penh was the case of a successful Chinese Vietnamese merchant from Cho Lon (the China Town in Ho Chi Minh city), who became a victim of political patronage in the Cambodian market.\(^{66}\) The merchant was a successful producer of chemical products in Vietnam. To expand his business to the Cambodian market, he first procured a Royal title by paying a large sum of money. He hoped that Royal patrons would function to protect his investment and help him enforce his contracts. He then invested in a factory outside Phnom Penh. Unfortunately, a vital incumbent in the local market had a patron in the military with more power, who “trumped” his Royal patrons. As soon as he learned this fact, the merchant fled the market without attempting to recover his investments.

In April 2004, many newspapers ran headlines concerning a military raid of a trade fair held in Phnom Penh. Cambodian soldiers surrounded the stalls of companies participating in the trade fair, most of them Vietnamese companies. As reported later in newspapers, the military raid was initiated by a Cambodian landlord seeking to strengthen his claim in a commercial dispute with the trade fair organizers, a Vietnamese company and a Cambodian company. Because the trade fair organizers

\(^{65}\) Merchant 13

\(^{66}\) The author was told of this story by Merchant 3, confirmed by Merchant 2.
were not at the trade fair site at the time of the raid, assets of companies attending the trade fair were held hostage by the military to secure the claim. The siege only ended when a Cambodian general mediated the dispute, and the trade fair organizers submitted themselves to the landlord, with a commitment to pay the overdue debt.

The above analysis is mainly evidenced by stories of capture of the state’s executive power. Nevertheless, similar analyses can also apply to the capture of judicial power, which is, of course, a branch of state power. If access to court enforcement of contracts is prohibitively costly, or restricted to a social group, merchants outside that social group need to seek private power to enforce their norms. If property rights and contractual obligations are not well recognized in laws, it becomes very expensive to establish rights, to prove obligations, and to measure damages. Unclear property rights and contractual obligations can also make access to court enforcement of contracts prohibitively costly. If courts are corrupt, attempts to use the court process to enforce contracts may turn into an all-pay auction to buy the court’s decision, in which both sides bid in competition to bribe corrupt judges. If bribery costs outweigh the benefit of court enforcement, then from the merchant’s perspective it is pointless to use courts. A corrupt court system may therefore make the threat of court sanctions to enforce contracts, impractical and lacking credibility. Facing a wronged promisee who threatens to sue, the promisor can make this threat hollow by proving an ability to pay corruption costs up to the value of court enforcement. This signals to the wronged promisee that if he or she wants to buy the corrupt court’s decision to
enforce the contract, they must pay a corruption cost higher than the value of court enforcement, something that would make little business sense.\textsuperscript{67}

In markets where state power, either executive or judicial, can be captured, patronage is one effective way of making a threat of contract enforcement credible. Money spent on patronage is a ‘sunk’ cost, which is most productive if used as often as possible. Once a merchant has procured a military or government official to patronise his or her business, he or she can threaten patrons to enforce or perform contracts. The threat of using patronage to enforce a contract is credible because the cost to procure the patronage has already been sunk, hence the promisee has the incentive to capitalize on patronage costs and is therefore more willing to mobilize patrons to enforce contracts.

Private power can be used as a governance structure to prevent opportunistic behavior in contracting. Where a promisor decides to breach his/her promise to limit losses, private sanctions in retaliation for the breach is a means for promisees to impose a cost upon promisors to a degree outweighing the savings made by the promisor through breaching the contract.

Given the nature of private power, which can be used unilaterally to impose a norm to advance the interest of the person with private power, a question that arises is why powerful merchants do not abuse their power by imposing inter-personal norms on their contracting partners for their own advantage? Do merchants with private power need to care about the market's norms if they have the power to enforce their own norms?

\textsuperscript{67}Peter Bardsley and Quan Nguyen, ‘Rent-seeking and judicial bias in weak legal systems (Working Paper, University of Melbourne Economics Department and Law School, 2004)
In the Nam Cam case, even the mafia boss of the underworld used his power carefully and justified its use in a manner consistent with the relational norms of the market. More particularly, Nam Cam’s criminals reportedly use their private power to enforce popular relational norms in the market such as chu-tin, reciprocity or fairness. Nam Cam justifies himself by proclaiming that he is not a killer, but merely a businessperson, (although beside legal business activities such as restaurants, he also ran illegal casinos). His primary use of captured state power is to cover-up or protect his illegal businesses, rather than using it against his business partners.

Returning to the question of why those with the potential to abuse private power do not do so more often, the use of private power in the Vietnamese market appears to be balanced by the process of selecting clients. Over-use of private power could scare potential clients away. The potential loss of clients is the main constraint upon powerful merchants with private power from ‘robbing’ their business partners. In addition, the existence of public institutions that support public ordering serve as BATNAs (Best Alternatives To No Agreements) in the bargaining game between a powerful merchant and his or her clients. These public institutions make it costly for criminals like Nam Cam to actually use their power to inflict damage upon others in the market. A balance between the costs of neutralizing the effects of these institutions and the benefit of enforcing private norms, is arguably the limit of private power.

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68 For a discussion of BATNAs in bargaining, see Roger Fisher, William Ury and Bruce Patton, *Getting to yes: negotiating an agreement without giving in* (2nd ed, 1997)
5. BUSINESS NETWORKS

In social science, there are two main ways that social relationships combine: (1) communalization of social relationships in which participants share some features of solidarity, or (2) aggregation of social relationships in which participants are motivated by rational value-judgments or expediency. On this premise, a business network is a bundle of relationships between individuals, who are motivated to enter the network by rational pursuit of economic ends. As a form of social organization, business networks can also be studied against the basic organizational structures of the market. In this part, I propose that traditional social structures of Vietnamese society help to enforce relational norms that regulate business relationships in the Vietnamese market.

Vietnamese people, as Woodside commented, have ‘communal instinct’. Throughout the long history of the country, the two dominant forms of social organization in this society have been the extended family (the clan) and the commune. In an agrarian society like Vietnam, extended family members traditionally constitute the main force for labour organization of agrarian production. The lifestyle of rice production arguably explains the cooperative behaviour and the hierarchical structure of Vietnamese clans, which can extend to nine generations and

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69 Max Weber, Basic Concepts In Sociology (1962) at 91

70 Alexander B. Woodside, Community and Revolution in Modern Vietnam (1976) at 5

71 Nguyen Van Huyen, The Ancient Civilization of Vietnam (1995) (discussing the three main institutions of Vietnamese society: the family, the commune, and the state. For the purposes of my discussion on informal structures of the market, the extended family (that is, the lineage) and the commune are the two dominant informal social structures)
include both the ancestry lines of husband and wife. Beside kinship, the bond among Vietnamese clan members is not only motivated by economic incentives of agricultural production, but as explored earlier, also by indigenous norms strongly influenced by the filial piety doctrines of Confucianism.

The Vietnamese clan was historically highly patriarchal, but in modern times the patriarch has lost much of his influence. Among the social forces that undermine the patriarchal structures of Vietnamese clans, Vietnamese scholars stress relative gender equality within indigenous Vietnamese cultures. Other factors suggested by scholars as tending towards equality include the French influence upon the conception of self and the family and the modes of residential mobilization during the resistance wars against the French and Americans. With the fading away of patriarchal power, the hierarchical structure of the Vietnamese clan is much weaker than its Chinese counterpart, but indigenous norms for cooperation among clan members remain

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influential and arguably nurture the emergence of equally potent clan-based business networks.

In discussing the relations between Vietnamese clans and business networks, it is necessary to explore the impact of the institution of marriage, which is a key means by which clan-based business networks expand. Marriage is ‘together with death, the most solemn domestic act’ that merges two families into one extended family.\(^{78}\) In traditional Vietnam, marriage is ‘a family affair and not a personal act concerning only the married couple’.\(^{79}\) Blood relationship is natural, but marriage can be rationally arranged by the clan’s leaders to achieve economic ends. For that reason, marriage serves the strategic extension of clan-based business networks better than blood relationships. It is not uncommon in big cities in Vietnam to see wedding parties of business families attended by a huge number of guests, sometimes more than one thousand people. Beside clan members, guests coming to a wedding party may reveal the extent of social and business networks of the family or the clan.\(^{80}\)

Besides the clan, the traditional Vietnamese commune also offers an organizational structure for business networks. The Vietnamese commune is traditionally an


\(^{79}\) Ibid

\(^{80}\) Because of the significance of marriage and other domestic rituals in the business life, the government has promulgated laws to limit spending and the number of guests attending wedding parties of government officials in an attempt to pre-empt corrupt practices among the state officials. See Direction 27/CT-TW dated 12/1/1998 of the Central Committee of the Polibureau of the VCP and Direction 14/1998/CT-TTg dated 28/3/1998 of the Prime Minister on wedding, funeral and festival rituals; and Official Letter 1546/CP.VX dated 30/11/2002 of the Government on marriage of civil servants and government cadres.
aggregation of several Vietnamese clans. Anh The traditional motivation for social organization in the Vietnamese commune was to achieve economic autonomy for members of the commune as well as political autonomy against oppressive feudal states or local chieftains.

In the modern history of Vietnam, residential mobilization during long military operations in the context of resistance wars, has arguably strongly influenced the organizational structures of traditional Vietnamese communes. However, given that more than seventy percent of Vietnamese population still live and work in the agricultural sector, it is difficult to deny the influence of agricultural communal structures upon the social structures of the modern Vietnamese market. In 1994, Phan Dai Doan, a distinguished professor of history in Ha Noi marveled that ‘abundant and complex forms of organizations’ emerged in rural villages for economic purposes following the end of collectivized farming in Vietnam.

Similarly, Adam Fforde and Nguyen Dinh Huan, in their survey of farmers’ organizations in three sample provinces, found that about half of the farmers they interviewed in Long An province were members of various voluntary ‘cooperative

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82 Ibid at 70


groups’ (tổ hợp tác), a form of rural business network. In Ninh Binh, a Northern province, 20 percent of surveyed farmers were involved in such business networks. In Quang Tri, a province in the central region, about 5 percent were in such business networks. This evidences the tradition of economic organizations in the Vietnamese commune.

According to many Vietnamese scholars, traditional Vietnamese communes have two important features: political autonomy and an informal structure. Political autonomy emerged out of economic autonomy and social organization of the commune: a self-sufficient social unit created by the bundling of one or several clans linked by marriage or blood relationships to cultivate common land. Political autonomy was especially strengthened during nearly a millennium of Chinese rule as resistance hardened against the foreign ruler and its assimilation attempts. As a consequence of this tradition of political autonomy, customary laws generally prevail over state laws within the commune, even in modern Vietnamese society. This phenomenon is well represented by the famous saying: ‘phép vua thua lệ làng’ (village rules “trump” state laws)


86 Ibid

87 Ibid

88 Ibid

89 Pham Duy Nghia, Essentials of Vietnam's Business Law (2001); Alexander B. Woodside, Community and Revolution in Modern Vietnam (1976)

90 Nguyen Van Huyen, The Ancient Civilization of Vietnam (1995) at 70

91 Pham Duy Nghia, Essentials of Vietnam's Business Law (2001) at 12-3
rules). Customary laws of the commune govern social relationships within the commune and dictate the organizational structure of the commune. Beyond this, Nghia Duy Pham argues that the customary laws of communes still govern relationships within business communities.

The organizational structure of business networks enforce relational norms among network members by providing the non-legal sanctions usually discussed in the literature as ‘reputation-based enforcement’. To understand how business networks function to facilitate contracting, it is worth considering the simple example of a

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93 On the informal structure of the Vietnamese commune, Alexander B. Woodside observed that the organizational structure of traditional Vietnamese villages ‘was based upon the imitation of semisacred patterns in classical ideology and not, as in Europe, upon written legal documents, such as village or municipal charter’. Alexander B. Woodside, Community and Revolution in Modern Vietnam (1976) at 283

94 Pham Duy Nghia, Essentials of Vietnam's Business Law (2001) at 21

'closed bag exchange’ developed by the cognitive scientist Douglas Hofstadter. Two merchants meet and exchange closed bags, with the understanding that one bag contains money, the other, a purchase. Each merchant can choose to honour the deal by putting into his bag what he has agreed to, or he can defect from the deal by handing over an empty bag. If this game is not repeated, handing over an empty bag is the best strategy for a selfish merchant. If merchants are exchanging bags within a group and the result of each transaction is reported to other members of the group, handing over an empty bag may not be the best strategy. A merchant reported to have handed over an empty bag would lose opportunities to benefit from exchange with other members of the group who would refrain from conducting future exchanges with the cheater. In that way, the transactional history of a merchant matters in determining his or her success in securing exchange within the group. A merchant would want to maintain a reputation for being honest in the group if the benefit of exchange within the group outweighs the benefit of handing an empty bag on a single occasion. It is also in the interest of the group to shunt out dishonest merchants, so that the market within the group can function more effectively.

Loss of reputation is the most discussed form of non-legal sanction provided by business networks. It has been argued that the enforcement mechanism based on reputation of networks depends on the size of networks as the probability of interaction between network members decreases when the number of network

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members increases. However, business networks may also provide sanctions by
inducing network members to specialize in exchange within the network. On the one
hand, specialization among network members can increase the productivity of
network exchange, reduce transaction costs of contracting out to a stranger, and
reduce the risks of a fluctuating market. On the other hand, specialization may
create locked-in relationships among network members and make network members
more dependent on the network to capitalize on asset specificity or relationship-
specific investment. It has also been observed in other markets that cross-investment
among network members is an intentional means of creating lock-in relationships
among network members in order to reduce the risks of asset specificity or
relationship-specific investment. In this way, cross-investment also increases
independence among network members.

For reputation-based sanctions to be effective, exchange of information between
relevant parties is critical. Because business networks in the Vietnamese market

97 Ethan Bueno de Mesquita and Matthew Stephenson, 'Legal institutions and the structure of informal
networks' (Harvard Law School, 2003)

98 This analysis follows the transaction cost theory of the firm which Ronald Coase postulated in his
famous article: Ronald Coase, 'The Nature Of The Firm' (1937) 4 Economica 386

99 Oliver E. Williamson, The Economic Institutions Of Capitalism (1985)

100 Ichiro Kobayashi, Relational Contracts in Japan: Reformation of Contract Practice under the
> 2004

101 Avner Greif, 'Reputation and Coalitions in Medieval Trade: Evidence on the Maghribi Traders'
(1989) 49 Journal of Economic History 491
usually rely on informal mechanisms to report on transactions within the network,¹⁰² social activities are essential for network members to exchange information about potential clients. In numerous group activities with other merchants, merchants learn about others, select who they should do business with, and seek contacts to approach these merchants for business deals.¹⁰³ Merchants also join business group activities to update private information about their on-going clients, and to adjust their positions in business transactions with the clients on the basis of analyzing private information about the clients dispersed in the market.¹⁰⁴ They normally try to collect private information about a new client from other merchants who have experience in dealing with the client before commencing business with that client.¹⁰⁵

My empirical survey found that local merchants engage in extensive networking as an important task of their daily business. Three merchants in Ho Chi Minh City interviewed – merchants 2,4 and 24 – belong to a lunch group. They meet regularly two or three times a week in numerous restaurants in the city that offer office lunches. Lunch meetings are arranged by SMSs sent by one member to mobiles of the group’s members. During these lunches participants share information about the market, whenever possible introduce new clients to one another, and occasionally even play chess to release stress accumulated in the course of their business. All of them are former university classmates, which created a strong bond for their cooperative

¹⁰² See Chapter 4; also John McMillan and Christopher Woodruff, 'Interim Relationships and Informal Credit in Vietnam' (1999) 114 Quarterly Journal of Economics 1285

¹⁰³ Merchants 5,7,8,9

¹⁰⁴ Merchants 7,8

¹⁰⁵ Merchants 10,24
relationships. Merchant 2 complained that he was very busy catching up with his
different business groups. Merchant 28 said he had four to five formal meetings per
day in socio-political associations of merchants such as the Vietnam Plastic
Association, or the Ho Chi Minh City Plastic Association, both of which he was a
member. He also had regular informal meetings with friends and clients. Time
commitments required to collect and maintain information, much as there, clearly
build into the transaction costs of the market.

Another support for the proposition that business networks evolve primarily out of
traditional social structures is the difference between the organizational structures of
business networks of the two surveyed groups: local Vietnamese merchants and local
ethnic Chinese merchants. Although operating within the same market, business
networks of local Vietnamese merchants tend to be more open than business networks
of ethnic Chinese merchants. Buon co ban, ban co phuong (traders have friends,
sellers have leagues) – said merchant 28 – ‘in each industry they [merchants] will
spontaneously group. It reflects the business relationship. For example, plastic textile
manufacturers, garment producers, distributors…it’s a natural relationship’.

According to my observations, business networks usually germinate from contacts
established amongst drinking groups, sport groups, friends’ groups, amongst friends’
friends,106 and former classmates.107 Besides being a member of the lunch group,
merchant 2, who was running an auditing firm, was a member of an evening tennis
group, playing every odd day of the week. Members of this group were lawyers,
judges and businesspeople involved in legal consultancy. His older brother, merchant

106 Merchant 4 and his networks

107 Merchants 2, 4 and 24, who are university classmates, with a strong cooperative relationship
1, who was running two factories producing construction materials, belonged to another tennis group of construction material manufacturers and traders. Occasionally he and his brother joined their acquaintances to play together hence creating an opportunity for members of the different tennis groups to meet each other, and possibly to create another tennis group. Subject to time and financial constraints, merchants may leave a group and enter another that provides him or her with greater business utility. Most business groups are open to new members, given that the incoming member usually brings more business utility to existing members.

Business networks of ethnic Chinese merchants tend to be more closed and communal. According to my observations, ethnic Chinese business networks tend to begin with members from the same language groups (Xuzhou and Cantonese language groups are the most populous Chinese communities in Vietnam). *Ka ki neng* in the Xuzhou community and *zhi ki danh* in the Cantonese community mean ‘our people’. A merchant becomes *ka ki neng* (Xuzhou language group) or *zhi ki danh* (Cantonese language group) when there is an established relationship with a member of the community (for examples, a Chinese parent, or spouse). The community’s members’ trust for *ka ki neng* or *zhi ki danh* is much higher than outsiders. In this way, networks form in a manner of ‘clustering’.

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108 Discussion with a group of Chinese ethnic merchants in Can Tho

109 Ibid

110 Ibid

The ethnic Chinese Vietnamese congregations and dialect groups (such as Fujian, Chaozhou, Hainan, Hakka or Cantonese) are traditional business networks. A surveyed Chinese merchant in Can Tho said that ‘Ninety percent of Chinese are active in Chinese networks’. The ethnic Chinese Vietnamese groups generally prefer doing business with clients from the same congregations or dialect groups. Until recently, the ethnic Chinese Vietnamese merchants in Can Tho City and Ho Chi Minh City still organized themselves into communities known as bang (congregations), according to their ancestors’ province of origin and dialect. These congregations and dialect groups (for examples, Fujian, Chaozhou, Hainan, Hakka or Cantonese) are still significant business networks for ethnic Chinese Vietnamese merchants, although some ethnic Chinese Vietnamese merchants interviewed said that the traditional role of these networks as client-procuring networks is diminishing.

Chinese merchants still tend to trust Chinese more than non-Chinese when they first meet. In busy Chinese business districts in Ho Chi Minh City, the question ‘are you Chinese?’ is often asked when people are first in contact for business. If the answer is ‘yes’, exchange is smoother and prices usually lower. It seems to the author that ethnic Chinese Vietnamese merchants interviewed in Can Tho province know in detail all other merchants in the same language group, and even across different Chinese language groups (for example, a Cantonese merchant would normally know

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112 Merchant 6

113 Merchants 6, 8, 9.

114 Merchant 9. He said that the number of ethnic Chinese Vietnamese merchants in his business area were few to do business with. In addition, as a wholesaler of fertilizers, he most of the time bought fertilizers from State-owned companies that had licenses to import fertilizers, and whose managers were mostly indigenous Vietnamese.
the family details of other Cantonese merchants in the same region, such as who
family heads were. A surveyed foreign (Western background) merchant in the
property development and construction industry in Vietnam said he has many
investments with local Vietnamese businesses, but none with ethnic Chinese
companies, although he knows the Chinese business community has enormous
business potential.\textsuperscript{115} Asked whether he has clients from the ethnic Chinese business
community, he answered: ‘Yes we have, but they are very hard to deal with…they
love to work together and are very, very wary about working with anybody outside of
their business circles’.\textsuperscript{116}

When business networks function well, formal contracting loses importance not only
because the need for court enforcement has been replaced by network sanctions, but
also because informal relational norms of the network replace the law in regulating
exchange among network members.

\section{6. The Significance of Social Rules}

From a bargaining point of view, if the transaction is discrete, that is, there is no
relationship between contracting parties,\textsuperscript{117} only contracts which are bargaining
equilibriums can be performed without being disputed.\textsuperscript{118} If the contract is not a

\textsuperscript{115} Merchant 33

\textsuperscript{116} Merchant 33

\textsuperscript{117} Ian R. Macneil, 'Contracts: Adjustment Of Long-term Economic Relations Under Classical,
Neoclassical, And Relational Contract Law' (1978) 72 Northwestern University Law Review 854

\textsuperscript{118} Jules L. Coleman, D. D. Heckathorn and S. M. Maser, 'A Bargaining Theory Approach to Default
Policy 639 <<Go to ISI>://A1989AT88800003>. Here the reader may dispute that although informal
bargaining equilibrium because parties do not have complete information at the time of contracting then, when uncalculated-for contingencies arise, one party may have an incentive to dispute the contract in order to reach a new contract that comes closer to a bargaining equilibrium. If a contract is truly a bargaining equilibrium, then the contracting parties would not ordinarily agree to renegotiation because any re-adjustment of the contractual terms would destroy the equilibrium and therefore would be disputed by the other party trying to re-acquire the bargaining equilibrium, which would make him/her better off.

When a discrete contract is merged into an infinite relationship, renegotiation is possible. An infinite relationship can create multiple bargaining equilibria, upon which parties can adjust their positions in the transaction. In real-life relational contracting, for example, if a merchant is requested by her client to compromise this time, she can expect her client to compromise in her favour the next time and therefore use the expected future benefit to balance the current cost of compromise. Or she may consider previous transactions when a client has extended a compromise to her and find herself obliged to reciprocate a basic norm or expectation of the contracting is not a bargaining equilibrium, the better-off party (because the contract is not a bargaining equilibrium, there will be, by definition, a better-off party and a worse-off party ) can somehow block the worse-off party from disputing the contract later on. But a bargaining equilibrium in informal contracting means that the equilibrium can still be reached between parties with unequal bargaining power. In this situation, the more powerful party can dictate norms that block the weaker party from later disputing the contract.

This argument is found on the Folk Theorem, widely known among game theorists, which says that when a game is repeated infinitely, players can accept any feasible outcome as an equilibrium of the game. For a discussion of the Folk Theorem, see, for example, Robert Gibbons, *A primer in game theory* (1992) at 88-120.
informal law governing merchants in the Vietnamese market.\textsuperscript{120} Or she may weigh up the costs of accepting losses caused by unanticipated contingencies against the benefit of maintaining her reputation as a promise-keeping businessperson in the market. The most efficient outcome in relational contracting is therefore the equilibrium of the overall relationship between contracting parties – which may include not only multiple economic exchanges but also personal, non-economic exchanges – instead of the bargaining equilibrium of a specific deal. It follows that renegotiation is acceptable between relational contracting parties in so far as it does not destroy the equilibrium of the overall relationship.

The question remains, however, as to what creates an ongoing relationship between contracting parties such that it can weather incomplete contracting? According to Weber, a social relationship exists where individuals can mutually base their behavior on the expected behavior of others.\textsuperscript{121} Individuals can only mutually base their behavior on the expected behavior of others if there are institutions that coordinate their expectations.\textsuperscript{122} Therefore, to maintain an ongoing social relationship between contracting parties, there must be institutions that coordinate the expectations of the parties.


\textsuperscript{121} Max Weber, Basic Concepts In Sociology (1962) pp 63-67

\textsuperscript{122} Douglass C. North, Institutions, Institutional Change, and Economic Performance (1990)
The legacy of market institutions in Vietnam suggests that traditional social structures of the market and indigenous norms that feature basic Confucian morality have been supporting relationships underlying exchange in this market. Traditionally, local merchants in the Vietnamese market were particularly interested in nurturing social relationships with their business partners in order to facilitate exchange. Nicholson provided some interesting observations on the dominance of relationships in this market:

The relationship (quân he) is extremely important in Vietnamese daily life even today, and this phenomenon grows out of the value placed on relationships by Confucian ethics. The family relationship is the most trusted, but personal relationships are also very significant. Once in a relationship of trust, professional and business relationships may emerge.\(^{123}\)

In Vietnam, this practice of merging commercial transactions into indefinite social relationships is particularly commonplace because the existence of traditional institutions in the market that, as investigated in this and the previous chapter, help to nurture and sustain social relationships.

CHAPTER 8 – THE SOCIAL STRUCTURES OF REAL-LIFE CONTRACTS

Previous chapters mapped out the institutional structure of the Vietnamese market. Observation and historical data suggest that there exists a ‘merchant law’ system, which developed from customary laws for commercial transactions in the traditional Vietnamese market and which features basic Confucian morality. This informal contract ordering system continues to order relational contract practice in the market because there are social structures that function as enforcement mechanisms for the ‘merchant law’.

Co-existing and co-functioning with the ‘merchant law’ system is a formal contract law system, introduced into the market during the last decade of economic reform. The current contract law system in Vietnam is largely a transplant of foreign contract laws. Contract laws were mainly borrowed from Western markets, which are unlikely to share the traditional social structure of the Vietnamese market. The drafting process usually ignores the incompatibility of foreign contract laws with local contract practices. Investigation into the formal contract law system suggests that borrowed contract laws largely fail to respond to relational contract practice in the market and are largely ignored in real life business transactions.

How does the institutional structure of the Vietnamese market influence contractual arrangements? And what is the role of contract law reform? This chapter analyzes the interrelationships between the ‘merchant law’ system, the contract law system, and contractual arrangements in the Vietnamese market. It argues that the ‘merchant law’ can marginalize contract law reform. It claims that incompatibility between the two
ordering systems increase transaction costs, opportunism and uncertainty in the market.

1. THE PROBLEMS OF CONTRACTING REVISITED

The theoretical root of contracts is the theory of exchange as propounded in the classics of Adam Smith.¹ We contract because we benefit from exchange of comparative values. For example, I want to sell my old car to buy a new car. I value my car at 700AUD. You like my car and you value it at 800AUD. You offer me 750AUD, and I accept. I benefit 50AUD from the exchange. You also benefit 50AUD from the exchange because you pay less than the value of the car to you. Both benefit thanks to our comparative valuation of the car. We also benefit from exchange because we can plan ahead upon the promises to optimize the use of our resources.² For example, if you promise me to buy my car at 800AUD next week because you do not have money now, and the current market price of my car is 750AUD, I can refrain from selling my car now and wait until next week to sell my car to you for 800AUD. If the extra 50AUD you pay me next week exceeds the utility to me of having 750AUD now, I clearly benefit from planning the sale of my car upon your promise.

There can be many ways to describe the contracting process, but in an institutionalist view this is a process of acquisition and alienation of property rights and freedom to act by the way of setting norms and enforcing norms.³ The exchange of promises in

¹ Robert L. Hale, 'Bargaining, duress, and economic liberty' (1943) 43 Columbia Law Review 603

² See, for example, Charles J. Goetz and Robert E. Scott, Enforcing promises: An examination of the basis of contract, 89 Yale Law Journal 1261 (1980)

³ See, for example, John R. Commons, 'Institutional Economics' (1931) 21 American Economic Review 648 (‘…transactions are, not the "exchange of commodities," but the alienation and acquisition,
contracting creates a set of norms that constrain the freedom to act of contracting parties therefore effecting the acquisition and alienation of property rights. A promise is legally defined as ‘an undertaking either that something shall happen or something shall not happen in the future’. If the promise is upheld, it limits the freedom to act of the promisor, just the way norms do. The exchange of promises in contracting is, therefore, the setting of norms that shapes the promisor’s conduct to bring about the process of acquisition and alienation of property rights.

In the complete information paradigm, the exchange of promises in contracting is a bargaining equilibrium, and therefore self-enforced because none of the contracting parties can do better than complying with the terms of the contract. But human beings have limited power of cognition, which makes it costly for them to acquire and

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4 American Restatement (Second) of Contracts # 2 (Tent. Drafts Nos. 1-7, 1973), for example, define a promise as ‘an undertaking either that something shall happen or something shall not happen in the future’.

5 For comparisons, a norm is generally defined as a normative way of doing things. See Peter Stein, *Legal institutions: the development of dispute settlements* (1984) at 1. Similarly, Robert Cooter defines a norm as ‘an obligation backed by a social sanction’, which would oblige the subject to behave in certain ways to satisfy the obligation. See Robert Cooter, ‘Three effects of social norms on law: Expression, deterrence and internalization’ (2000) 79 Oregon Law Review 1 at 5

process information. The real paradigm of contracting in the real market is therefore an incomplete information paradigm.\(^7\)

In the incomplete information paradigm, the ‘contract as bargaining equilibrium’ fails when, to use the words of Goetz and Scott, ‘regret contingencies’ arise.\(^8\) A ‘regret contingency’ denotes the occurrence of a contingency in the market during the execution of a contract that would make the promisor regret about his promise, that is, the promise is no longer the best choice of action.\(^9\) If the promisor dishonors his promise, the promisee may suffer reliance costs, which is the inefficient use of resources that she has allocated in expectation of the promise.\(^10\) If the promisor honors his promise, he suffers regret costs, which is the difference between the best choice of action in the new condition of the market and the performance of the promise.\(^11\) Assuming that reliance costs and regret costs are positive, the occurrence


of a regret contingency in the market implies that either promisor or promisee must bear a cost. This may not be a net loss, but it an opportunity cost.

I generalize the situations of regret contingencies in the following four situations: (1) the expected profit of exchange is enhanced; (2) the expected profit of exchange is exactly as expected; (3) the expected profit is reduced; and (4) execution of the contract produces losses compared with the status quo.\(^\text{12}\)

In practice, there are opportunistic incentives to breach norms in all four situations: In the first situation, parties may want to breach norms to seize the enhanced profit; In the second situation, parties may want to re-negotiate norms to get a larger share of profit they agreed to \emph{ex ante}; In the third situation, parties may want to breach norms because they don’t want a reduced share of profit; In the fourth situation, parties may want to breach norms to avoid the losses.

In addition, in all of these situations, there is a risk that one party may behave opportunistically to capture the other party’s relation-specific investment in the transaction. It is usually observed in the contract literature that many exchanges in the market require the promisor to commit in relation-specific investment to deliver a specialized product or service that fit a specific need of the promisee.\(^\text{13}\) If relation-specific investment is not redeployable, once the promisor has incurred relation-

\(^{12}\) See Figure 1, Appendix

specific investment, the promisee can opportunistically demand to renegotiate the contract to capture a part of the investment.\textsuperscript{14}

Drawing on this analysis of the contracting process, I contend that the two main problems of contracting are, first, incomplete information about future occurrence of ‘regret contingencies’, and, second, opportunism. As Williamson argued, if contractors are not opportunistic, they can simply adjust the contract to optimize the economies of ‘regret contingencies’.\textsuperscript{15} Opportunism is therefore the main cause that undermines the value of promises to project exchange into the future. Credible promises must, therefore, be accompanied by incentive structures that assure the compliance with the promises.

\section*{2. Incompatible Contract Ordering Systems}

As noted, the bargaining theory of contract suggests that contracting to project exchange into the future faces two main problems: incomplete contracting and opportunism. This section contends that the solution to contracting problems is not uniquely sought from the contract law system, but can be sought from institutional


\footnotesize{\textsuperscript{15} Oliver Williamson, \textit{The Economic Institutions of Capitalism} (1985) at 31 (‘Although gaps will appear in these contracts, because of bounded rationality, they do not pose execution hazards if the parties take recourse to a self-enforcing general clause. Each party to the contract simply pledges at the outset to execute the contract efficiently (in a joint profit maximizing manner) and to seek only fair returns at contract renewal intervals. Strategic behavior is thereby denied. Parties to a contract thus extract all such advantages as their endowments entitle them to when the initial bargain is struck. Thereafter contract execution goes efficiently to completion because promises of the above-described kind are, in the absence of opportunism, self-enforcing’)}
structures of the market. In the case of the Vietnamese market, institutional structures of the market constitute a merchant law system. However, this merchant law system may differ from the contract law system in many important aspects that make the two ordering systems incompatible in supporting contracting in the market.

Naturally, the farther exchange is projected into the future, the more likely contracting is incomplete, and the more likely it is that ‘regret contingencies’ will arise, because it becomes less likely parties can predict precisely what is going to happen in the market. Without assurance that promises will be honoured, the promisee would not want to allocate resources upon promises to plan an exchange into the future, if the prospective reliance cost incurred by opportunistic behaviour is high. In many transactions, reallocation of resources to plan a future exchange upon a promise also require transacting parties to place their assets in the possession and use of other parties, hence exposing these assets to the risk of being captured by other parties. Everyday examples include the sale of goods with deferred payment; putting money into a bank account (the money is then under the bank’s control); or buying shares or bonds of a company listed in the stock market etc. When the prospective risk outweighs the prospective benefit of exchange, no exchange will be projected into the future, and consequently very few exchanges can actually take place in the market.

Contracting problems are, in nature, the problem of uncertainty, which can be uncertainty about the market (in case of incomplete information), and/or more importantly, uncertainty about the contract behavior of the transacting partner (in case

16 Ibid, at 29-30. In Oliver Williamson's analysis, this is the costs of asset specificity

17 This analysis is based on the experience of Merchant 6, whose investment in his joint-venture was almost captured by his business partner. See Chapter 7
of opportunism). A solution to the problem of uncertainty would require an institutional structure to coordinate expectations (in planning exchange into the future), and to provide incentive structures against opportunistic incentives (for breach of contract or capture of investments).\footnote{18} Such an institutional structure is not unique to the legal system, and particularly not the contract law system.\footnote{19} Institutions are, to use the words of North, 'the constraints that human beings impose on human interaction'\footnote{20} in order 'to reduce the uncertainties involved in human interaction'.\footnote{21} The structure of institutions is basically composed of a set of norms and incentive structures that induce compliance with norms. In a legal system, legal norms tell the subject what to do in prescribed circumstances, and the state coerces compliance with legal norms by using state monopoly coercive power.\footnote{22}

\footnote{18} Institutional solution to the problems of cooperation in market exchange is also discussed in Douglass C. North, \textit{Institutions, Institutional Change, and Economic Performance} (1990)

\footnote{19} There is a vast literature on legal pluralism, the tenet of which is the existence of multiple ordering systems in the society that can substitute the court in solving disputes. Representative works include Marc Galanter, 'Justice in Many Rooms: Courts, Private Ordering, and Indigenous Law' (1981) 19 \textit{Journal of Legal Pluralism} 1; John Griffiths, 'What Is Legal Pluralism?' (1986) 24 \textit{Journal of Legal Pluralism} 1; Leopold Pospisil, 'Legal Levels and Multiplicity of Legal Systems in Human Societies' (1967) 11(1) \textit{The Journal of Conflict Resolution} 2

\footnote{20} Douglass C. North, 'Five propositions about institutional change' in Jack Knight and Itai Sened (eds.) \textit{Explaining Social Institutions} (1995) at 15. One can find various definitions of institutions in the literature as well. For example, John R. Commons, a well-known institutional economist, defines: ‘an institution is collective action in control, liberation and expansion of individual action’. See John R. Commons, 'Institutional Economics' (1931) 21 \textit{American Economic Review} 648

\footnote{21} Douglass C. North, ibid at 25

\footnote{22} See, for examples, H.L.A Hart, \textit{The Concept of Law} (1961); Hans Kelsen, 'The pure theory of law and analytical jurisprudence' in Hans Kelsen (ed), \textit{What is justice? Justice, law, and politics in the mirror of science - collected essays by Hans Kelsen} (1957) 266
But state coercion is not the unique incentive structure in a society. Private ordering scholars suggest there are three other types of non-state incentive structures that enforce social norms in non-state ordering systems: (1) internal sanction; (2) retaliation; and (3) social sanction. These social ordering systems can also provide an institutional structure to the problems of contracting. In primitive societies, for example, exchanges could be conducted based upon basic norms familiar with modern contract law such as fair exchange, substantial equality or non-bindingness of gift. Chinese middlemen engaged in the marketing of smallholders’ rubber in Singapore and West Malaysia also rely on a relational ordering system that substitutes the contract law system in ordering contracting among this ethnic group. Such a non-state ordering system exists in Vietnam in the form of the merchant law system, as discussed in previous chapters.

Drawing on the institutional structure of the Vietnamese market, the ‘merchant law’ system and the formal contract law system may differ in their norms, enforcement mechanisms, incentive structures, as well as transaction costs they incur for their use to solve the problems of contracting. Figure 2 in the Appendix compares the institutional structures of the two contract ordering systems in the Vietnamese market.


24 Karl Llewellyn and Adamson Hoebel, *The Cheyenne way: Conflict and case law in primitive jurisprudence* (1941)


26 Chapters 4, 6 and 7
and shows that the contract law system is an institution which is composed of a set of norms which are substantive and procedural laws. The enforcement mechanism is mainly the legal process. Incentive structures are sanctions and costs that the legal process imposes on a promisor who breach his or her promises. These incentive structures can be contractual damages, restitution, specific performance, injunctions, or even court costs. If the costs outweigh 'regret costs' plus the benefit of capturing the promisee's investments (if any), then the promisor has no incentive to behave opportunistically. Default rules help to fill out gaps in incomplete contracting, therefore reducing uncertainty of planning exchange into the future.

The ‘merchant law’ system in the Vietnamese market has a set of default rules, which developed out of customary laws and which feature basic Confucian morality.

Enforcement mechanisms in the ‘merchant law’ system are traditional organizational

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27 Not all promises are recognized and enforced by the contract law system. An obvious example is promises in human trafficking or drug trafficking contracts

28 For contractual remedies, see, for example, Peter Heffey et al., Principles of Contract Law (2002). For the use of court costs or the legal process as a sanction, see Peter Bardsley and Quan Nguyen, 'Rent-seeking and judicial biased in weak legal systems' (Working paper, Melbourne University Economics Department and Law School, 2004) (On file with author)

structures of the Vietnamese market. Incentive structures are not derived from the monopoly coercive power of the state, but from reputational sanctions and retaliation.  

The contract law system differs from the ‘merchant law’ system not only in its institutional structures, but also in the ways it functions. In the contract law system, the court presumably has the ultimate power to interpret default rules to fill gaps in contracts, while the ‘merchant law’ system suggests default rules and contracting parties interpret the default rules themselves through renegotiation to fill gaps in their contracts.

Looking more closely, both the contract law system and the ‘merchant law’ system help to fill gaps in incomplete contracting by providing contracting parties with a bargaining framework. In the contract law system, although the court can ‘step out of the shadow’ to dictate the norms to contracting parties, in most situations the court stays ‘in the shadow’ to let parties make their own norms based on their anticipation of what the court will say. In the ‘merchant law’ system, parties do not bargain ‘in the shadow of the law’, but in the scrutiny of the market, the threat of exclusion from their business networks, of retaliation with private power, or of loss of future relationships.

30 See Chapter 7

31 For bargaining in the shadow of the court, see Mnookin and Kornhauser, supra note 7; Robert Cooter et al., ‘Bargaining in the shadow of the law: A testable model of strategic behavior’ (1982) 11 Journal of Legal Studies 225. For an empirical study of settlement of legal dispute, see Herbert M. Kritzer, Let's Make A Deal: Understanding the Negotiation Process in Ordinary Litigation (1991) (finding that most legal disputes are settled out of the courtroom)

32 See Chapter 7
Ultimately, the difference between court ordering and private ordering systems is whether the power to enforce norms comes from the state’s power (or the Prince’s power, in the jargon of Thomas Hobbes), or non-state power such as internalized sanctions, retaliation, hostage, or group sanctions.

The concept of a contract as it is recognized and enforced in the formal contract law system may differ significantly from the ‘contract’ as it is recognized and enforced in the ‘merchant law’ system. In a commercial context, the court would normally recognize a contract by three main signals: an offer, an acceptance and consideration. Contract law presumes that contractual arrangements reflect a bargaining equilibrium of a one-off deal through total presentation. Contract theories argue that default rules of contract law should be designed to fill gaps in contractual arrangements to achieve Pareto efficient outcomes for each one-off deal. Request for renegotiation of contractual terms during contractual performance can be seen as unethical or harmful for business.

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34 See Chapter 6

35 See, for example, Hugh Collins, *The law of contract* (1997) at 48 (Noting that the court applying tests of enforceability would carve a contract out of the context of a transaction, and that this contract may not reflect precisely what parties intend to be a contract among themselves)


These principles are not the norms of the ‘merchant law’ system in the Vietnamese market. Relational norms of the ‘merchant law’ system also help to fill gaps in incomplete contracting and to discourage opportunistic behavior.\textsuperscript{38} However, relational norms tend to induce contractual arrangements that aim for overall efficiency of the whole relationship, which may interweave business deals with personal deals between contracting parties.\textsuperscript{39} In economic terms, this means that a request for renegotiation that leads to Kaldo-Hicks efficiency in individual deals can be acceptable in the merchant law system. However, given the common relational norm of reciprocity (nghĩa) in the Vietnamese market, merchants are expected to exercise the principle of reciprocity throughout the whole relationship so that Kaldo-Hicks efficiency in individual deals would be reallocated among the deals between the parties to make the overall relationship Pareto efficient for both sides.\textsuperscript{40}

As a consequence of the different concepts of ‘contract’ in two ordering systems, a breach of contract has different meanings in the ‘merchant law’ system from the contract law system. In the contract law system, it is a general principle that

\textsuperscript{38} See Chapter 5

\textsuperscript{39} See Chapters 6 and 7

\textsuperscript{40} An easy way to distinguish between Pareto efficiency and Kaldo-Hicks efficiency regarding the performance of A’s promise to B is to ask: would performance of the promise make B better off without making A worse off? If the answer is positive, then the transaction is said to be Pareto efficient. If the answer is negative, then ask: would B still be better off if she pays A enough so that A would not be worse off? If the answer is positive, then the transaction is said to be Kaldo-Hicks efficient. If the answer is negative for both questions, then performance of the promise is said to be inefficient because it produces a net loss. I discussed how relational contracting parties may accept Kaldo-Hicks efficiency by allowing re-adjustment throughout the life of a transaction in Chapter 6 I also discussed relational norms that induce re-adjustment in contract practice in the Vietnamese market in Chapter 5
contractual obligations must be strictly performed. For example, in the formal contract law system, a request for renegotiation can usually be interpreted as anticipatory breach of contract, and invoke legal actions.

The principle of strict performance is clearly not strictly upheld in the ‘merchant law’ system in the Vietnamese market as discussed in Chapters 6 and 7 of this thesis. The business morality of the ‘merchant law’ system in the market actually encourages a flexible contractual relationship in which transacting parties can re-adjust their contractual positions in response to changes in the market. Given the flexibility of contractual relationships in the Vietnamese market, the breach of ‘contract’ according to the ‘merchant law’ system usually means the breach of relational norms which local merchants believe will help maintain the efficiency of an overall and on-going relationship between contracting parties.

In addition, remedies that are usually provided by the court for breach of contract in legal actions are usually not available in the ‘merchant law’ system. The main contract law remedies include damages, restitution, and specific performance. These remedies result in a transfer of wealth from a promisor who breach a promise to a promisee who is damaged as a consequence of the breach of promise, or the specific

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43 See Chapter 5

44 Some representative relational norms are discussed in Chapter 6

performance of the promise. The aim is to make whole the promisee, to bring the promisee back to a situation she would be if the promise is not breached. In the ‘merchant law’ system, a damaged promisee can rarely seek a transfer of wealth to compensate damages, except though the use of private power to force a transfer. Relational norms of the ‘merchant law’ encourage flexibility and renegotiation to maintain the relationship rather than to seek revenge or invoke sanctions. Institutional structures in the market are also not available to make whole the damaged promisee, to bring her back to the situation she would be if the promise was not breached.

Finally, the two ordering systems apparently differ in the transaction costs incurred by their uses to solve the two problems of contracting. In transactions arranged within the framework of the formal contract law system, most transactions are incurred ex post. Even the costs of engaging lawyers for legal drafting work are usually incurred after business people have negotiated the deal. During the stage of contractual performance, parties can invoke the legal process only when a cause of action arise, that means, when disputes arise. Invoking the legal process would then incur

46 Peter Heffey, Jeannie Paterson and Andrew Robertson, Principles of Contract Law (2002)

47 This is perhaps the most basic principle of contract law. For a classic discussion of this principle, see, for example, Lon L. Fuller and William Perdue, 'The reliance interest in contract damages' (1936) 46 Yale Law Journal 52

48 See Chapter 6

49 See Chapter 7


51 O. L. McCaskill, 'Actions And Causes Of Action' (1924-25) 34 Yale Law Journal 614
transaction costs. To the contrary, most transaction costs are incurred *ex ante* in the ‘merchant law’ system. Learning relational norms of commercial practices can be a lifetime experience of local merchants.\(^{52}\) Building trust in relationships, procuring private power, or setting up and maintaining business networks is usually a lengthy process of investment and effort that precedes actual transactions.\(^{53}\)

### 3. Costs of Transfer and the Selection Between the Two Contract Ordering Systems

Drawing on the fact that, in the Vietnamese market, the ‘merchant law’ system and the formal contract law system are incompatible in many important aspects, a question arises: can merchants always ‘shop’ for the best ordering system for each of their contractual arrangements? My claim is that it is costly to transfer contractual arrangements between the two contract ordering systems in the Vietnamese market and that the cost of transfer and the profit margin in the market induces merchants to rely heavily on one ordering system and to ignore the other.

It has been argued in the literature that people can devise a ‘wealth maximizing’ ordering system for themselves if the formal law system fails to deliver a desirable outcome.\(^{54}\) This argument fails to take into account the facts that, first, merchants face the problem of *bounded rationality*, (that means, they may not be able to work out an

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\(^{52}\) Hai Dang, ‘Chữ tín là ‘đạo’ của kinh doanh’ (trans: Chu-Tin is the faith in business), *Tuoi Tre* (Ho Chi Minh City), 9/10/2004

\(^{53}\) See Chapter 7

\(^{54}\) See, for example, *Robert C. Ellickson, Order Without Law: How Neighbors Settle Disputes*. 1994. (theorizing that ranchers can create ‘wealth-maximizing’ norms to regulate their relationships)
equilibrium contractual arrangement although they have complete information about the transaction)\textsuperscript{55} and second, they may not have complete information about the market in order to devise a ‘wealth-maximizing’ ordering system.\textsuperscript{56} In the Vietnamese market, surveyed local merchants tend to arrange their transactions on the basis of the traditional ‘merchant law’ system, instead of creating one for themselves, although they also claim that the ‘merchant law’ system is not a ‘wealth maximizing’ one.\textsuperscript{57}

It has also been argued in the literature that private ordering systems ultimately function ‘in the shadow of the law’.\textsuperscript{58} This argument is founded on the assumption that relational norms that conflict with legal norms would lose ordering power because the monopoly power of the state to enforce the law would negate it.\textsuperscript{59} This argument is apparently not supported by the fact that in the Vietnamese market a ‘merchant law’ system exists and functions incompatibly with the formal contract law.

\textsuperscript{55} Oliver E. Williamson, \textit{The Economic Institutions Of Capitalism} (1985) at 31

\textsuperscript{56} This is a key proposition of the economics of information literature. See, for example, Joseph E. Stiglitz, \textit{Information And The Change In The Paradigm In Economics - Nobel Prize Lecture} (2001) <www-1.gsb.columbia.edu/faculty/jstiglitz/download/NobelLecture.pdf> 26/12/2004

\textsuperscript{57} This observation is supported by surveyed merchant 24, who commented in his in-depth interview that he reluctantly follows the informal contract practice in the market. See Chapter 4

\textsuperscript{58} Hillman, ‘The crisis of modern contract theory’ (1989) 67 \textit{Texas Law Review} 103 at 131 (‘contract law is a ‘club’, held in reserve, that reinforces parties’ business cultures’)

\textsuperscript{59} This assumption is consistent with the view of law in normative jurisprudence. See, for example, Hans Kelsen, ‘The pure theory of law and analytical jurisprudence’ in Hans Kelsen (ed), \textit{What is justice? Justice, law, and politics in the mirror of science - collected essays by Hans Kelsen} (1957) 266 (‘…[t]he law of nature formulated by natural science must conform to the facts, but the facts of human action and refrainment ought to conform to the legal norms described by the science of law…’)

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system to order contractual arrangements. These arguments may not always explain real life contractual arrangements in the Vietnamese market because, as I argue in the following paragraphs, they do not take into account the costs of transfer of contractual arrangements between the ‘merchant law’ system and the formal contract law system.

The incompatibility in important aspects of the two contract ordering systems creates the costs of transfer when merchants want to bring their contractual arrangement from one ordering system to the other. The transfer of contractual arrangements between the two systems occurs when parties arrange their transactions upon the norms and incentive structures of one ordering system, but then seek to enforce these transactions in the other system. This happens when, for example, relational contracting parties decide to go to court to settle a dispute that arises out of the transaction and that cannot be settled in the merchant law system. The court then applies contract law to interpret the parties’ contractual arrangements, which may produce outcomes that differ from the original arrangements of the parties if interpreted according to relational norms. The cost for the transfer between the two systems in this situation arguably includes the costs of proving the existence of relational arrangements in a way that is recognized by the contract law system, and the loss of some relational arrangements that are not recognized and enforced in the contract law system.

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60 See Chapters 6 & 7


62 These are arguably relational arrangements on entitlements under inalienability rules of the law, to use the ‘property rules, liability rules, and inalienability rules’ framework of Guido Calabresi and A.
To elaborate more on the costs of transfer of contractual arrangements between ordering systems, first, the formal contract law specifies which economic interests can be seen as ‘contractual rights’ that can seek to be protected by the legal process. Only ‘rights’ that fall within the scope of contract law can enter the court process as contractual claims for court enforcement. If the ‘merchant law’ system and the formal contract law system are incompatible, then there may be economic interests that are recognized and enforced in the ‘merchant law’ system but not recognized and enforced in the formal contract law system and vice versa. The transfer of contractual arrangements from the ‘merchant law’ system to the formal contract law system would result in a loss of these economic interests predicated on informality.

Secondly, the legal process to recognize and enforce contractual rights is not costless, but, in many circumstances, prohibitively costly. If court costs outweigh the value
of the ‘rights’, a rational litigant would presumably waive these rights. This point has been exploited vigorously in the literature on nuisance suits. Naturally, contracting parties who value relational interests in contracting more than contractual rights may rely less on court ordering and more on relational institutions, which may provide better assurance for their relational interests.

Thirdly, a contract law that restricts freedom of contract, a poorly designed legal procedure, or a dysfunctional court may further filter out economic interests that can enter the court process as ‘rights’ to seek court ordering assurance. This is particularly true of the Vietnamese market during the command economy era. As indicated in Chapter 5, the Ordinance on Economic Contracts was drafted within a constitutional framework that denied the market. The Chinese legalism and Marxist economics approach of the law drafters did not aim to promote economic efficiency in market transactions. The Economic Court played the role of a policeman enforcing the state’s restrictive policies on the market, rather than enforcing bargained-for promises.

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67 For some representing works in the literature on nuisance suits, see David Rosenberg and Stephen Shavell, 'A model in which suits are brought for their nuisance value' (1985) 5 International Review of Law and Economics 3; Amy Farmer and Paul Pecorino, 'A reputation for being a nuisance: Frivolous lawsuits and fee shifting in a repeated play game' (1998) 18 International Review of Law and Economics 147

68 See Chapter 5
in the market. During this period, most economic interests in market transactions in the ‘shadow economy’ were outlawed. The transfer of a market transaction in the ‘shadow economy’ into the framework of the formal contract law system could risk a total loss of the economic interests in the transaction.

If there are no costs of transferring contractual arrangements between incompatible contract ordering systems, then merchants would arguably arrange their transactions in the ‘shadow of the law’. The lack of state coercive sanction in the ‘merchant law’ system would induce contracting parties to bring their contractual disputes before the court when they exhaust informal incentive structures of the ‘merchant law’ system. This is a widely held assumption in the contract law scholarship. Karl Llewellyn, for example, argued that contract law is ‘a norm of ultimate appeal when relations cease in fact to work’. In reality, transfer of contractual arrangements between the ‘merchant law’ system and the contract law system can be prohibitively costly. To see why, assume that transactions in the market have a profit margin. The profit margin of a market is usually determined by competition in the market. If the costs of transfer of contractual arrangements from the ‘merchant law’ system to the contract law system to settle a

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69 See Chapter 5

70 See Chapter 5

71 See Chapter 5, especially my discussion on the criminalization of economic activities during the command economic era


dispute arising out of the transaction is higher than the profit margin of the
transaction, then such a transfer produces a net loss for the transacting parties, despite
the fact that such a transfer may help merchants to settle their dispute.

If the cost of transfer is higher than the profit margin in the market, it raises a ‘fence’
between the informal ‘merchant law’ system and the formal contract law system.
When the prospect of shifting from the ‘merchant law’ system to the contract law
system to settle future disputes looms large, relational contracting parties would not
want to enter the transaction. Who is going to invest in a loss-making deal?\(^{74}\) The
question that commercial wisdom would seek to answer before entering a relational
contractual arrangement is therefore whether the ‘merchant law’ system is good
enough to support the transaction through to completion, rather than whether the
contract law system is good enough to fall back on if relational incentive structures
are exhausted. If the answer is positive, the contracting process may proceed. If the
answer is negative, there is no contracting.

The market selection between the ‘merchant law’ system and the formal contract law
system may result in very few contractual arrangements being actually based upon the
contract law system. It can be argued that some disputes eventually go to court
because the damaged party has exhausted relational solutions and now tries to save
whatever she can through the contract law system. To the contrary, however,
merchants can always learn from the past to plan their future transactions. The more
they transact, the more experienced they are in planning their contractual
arrangements on the basis of the ‘merchant law’ system, and the less likely they fall

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\(^{74}\) This partly explains why some local merchants in the Vietnamese market refuse to deal with people
who they think are ‘litigious’. See Chapter 3, in-depth interviews with merchants 4 and 20
back to the formal contract law system. Those who fail to do so, and frequently fall back on the formal contract law system to enforce their contractual arrangements, may have to walk out of the market because they cannot generate enough profit to stay in business.

In addition, the less often merchants fall back on the formal contract law system to seek solutions for their business disputes, the less likely they are to want to use it because they don’t know how it works and it is costly to learn how it works. As discussed earlier, uncertainty is the nature of the problems of contracting. So the hypothesis that merchants must fall back to the court when they exhaust relational incentives must be balanced by the effectiveness of the ‘merchant law’ system; the ability of merchants to arrange their transactions so that they will not have to fall back on the court when ‘regret contingencies’ arise; and competition in the market that excludes those merchants who fail to do so.

Besides selecting between the two ordering systems to avoid the cost of transfer, merchants may also do so to economize on transaction costs. From an institutional perspective, resolving the problems of contracting is the task of setting norms to project exchange into the future and enforcing norms set. Based on this proposition, setting norms must first consider how the norms set would be enforced. The effectiveness of norms in guiding conducts depends on how the norms are enforced. More specifically, the incentive structures embedded in the enforcement mechanism must be strong enough to outweigh regret costs and opportunistic gains. Therefore, in selecting norms, commercial wisdom would follow backward induction, that is, the
selection of available incentive structures to induce compliance with norms would precede, and determine, how norms are set for the transaction.\textsuperscript{75}

The selection of incentive structures is, in effect, the selection between contract ordering systems. When contracting parties set norms for their contractual arrangements by exchanging promises, and select incentive structures to enforce promises, they, in effect, select between the two contract ordering systems to support their contractual arrangements. For instance, in the Vietnamese market, merchants may select to arrange their transactions under the ‘merchant law’ system by incurring \textit{ex ante} investments in establishing informational channels, or business networks, or procuring private power.\textsuperscript{76} Or they may select to arrange their transactions in the shadow of the law by engaging in formal negotiation and drafting of contracts.\textsuperscript{77}

The selection of incentive structures to enforce norms determines the way merchants set norms for their contractual arrangements. This is especially when default norms are incompatible and each incentive structure exclusively enforces a set of default norms. The contract law system, for example, exclusively enforces legal norms, although the court may interpret legal norms to embrace relational norms such as commercial usage and trade practice. Norms set for contracting for illegal purposes or prohibited products such as trade collusion, procurement rigging, or property right violations; or for the exchange of illegal goods such as drugs and weapons would presumably not be enforced by legal incentive structures. There is, therefore, an

\textsuperscript{75} For a discussion of backward induction in behavioral theory, see Avinash Dixit and Barry Nalebuff, \textit{Thinking strategically: The competitive edge in business, politics, and everyday life} (1991)

\textsuperscript{76} See Chapter 7

\textsuperscript{77} See Chapter 5
interaction between the task of setting norms for exchange and the task of selecting incentive structures to enforce norms set.\textsuperscript{78}

Because institutions differ in the transaction costs that they incur, the selection of institutions in contracting can arguably produce the effect of optimizing transaction costs. For instance, the surveyed CEO of the telecommunication company I interviewed in Ho Chi Minh City preferred formal contracting to trust-based business deals because he was accustomed to, and arguably more effective at using, the formal contract law system to support contractual arrangements.\textsuperscript{79} Meanwhile, his ethnic Chinese Vietnamese executive found himself more effective in using the ‘merchant law’ system.\textsuperscript{80} Generally, if a merchant has incurred \textit{ex ante} investments in the ‘merchant law’ system, it is more likely that he or she would want to set norms and enforce norms using the ‘merchant law’ system in order to capitalize on the investments. On the assumption that contracting parties pursue wealth maximization,

\begin{flushleft}
\textsuperscript{78} It can be argued that in the freedom of contracting paradigm, contract law aims to recognize and enforce private agreements on whatever norms they set, following some basic principles such as consideration. However, contracting as an act of transferring titles would involve not only contract law but also property law and other laws to regulate the market, such as competition law or trade practice. The contract law system I discuss here has a broad meaning. It includes all relevant laws for the purpose of the contract. The contract law system in that sense may not enforce agreements that violate property rights, trade practice laws etc. Therefore, the selection of norms in contracting still makes sense for effective enforcement.

\textsuperscript{79} See Chapter 4, in-depth interview with merchant 24

\textsuperscript{80} Chapter 4, in-depth interview with merchant 24.
\end{flushleft}
it can be argued that contracting parties select among available institutional structures in the market to economize on transaction costs.\textsuperscript{81}

4. **INCOMPATIBLE CONTRACT ORDERING SYSTEMS, OPPORTUNISM, AND RELATIONAL CONTRACTING**

How then is selection between incompatible ordering systems in the Vietnamese market relevant to the functioning of the market? In other words, does the choice of ordering systems facilitate or hinder transactions in the market? It is argued here that incompatibility between the ‘merchant law’ system and the formal contract law system exacerbates incentives for opportunistic contract behavior and also increases the transaction costs of setting norms and enforcing norms in contractual arrangements.

The fact that the ‘merchant law’ system and the formal contract law system in the Vietnamese market are incompatible in many important aspects was discussed in Chapters 5 to 7 of this thesis. The fact that incompatibility between the two contract ordering systems creates the cost of transfer of contractual arrangement between the two ordering systems was also discussed in the previous section of this chapter. The fact that if the cost of transfer is higher than the profit margin in the market, merchants choose to stay in one contract ordering system and ignore the other was also discussed. This section explains how the selection between the two imperfect contract ordering systems may increase opportunistic contract behavior and transaction costs of contractual arrangements in the market.

\textsuperscript{81} Oliver E. Williamson, *The Economic Institutions Of Capitalism* (1985) at 17 (‘The economic institutions of capitalism [firms, markets and relational contracting] have the main purpose and effect of economizing on transaction costs.’)
The argument follows this structure: if the cost of transfer is higher than the profit margin in the market, merchants have to choose to arrange their transactions upon either the ‘merchant law’ system or the formal contract law system and to ignore the other. However, neither the ‘merchant law’ system nor the formal contract law system offers perfect solutions to contracting problems. Both the ‘merchant law’ system and the formal contract law system can leave the promisee vulnerable to opportunistic contract behavior. Strategies of contract governance that seek more protection from opportunistic contract behavior increase transaction costs of contractual arrangements in the market.

The contract law system does not fully protect the promisee from opportunistic contract behavior. If the promisee relies on the contract law system, most of transaction costs to enforce the contract and to resolve contract disputes would be incurred ex post when regret contingencies arise and the promisor behaves opportunistically, because the court process can only be invoked during ex post execution when the promisee has evidence that the promisor breaches the norms set for the exchange.\(^2\) Contract law remedies such as damages, restitution, specific performance and injunctions are enforcement mechanisms of the contract law system exclusively designed to enforce contractual rights.\(^3\) However, it is well recognized that contract law remedies may not fully compensate the promisee for disadvantages caused by the promisor behaving opportunistically.\(^4\) In addition, civil procedures

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\(^2\) O. L. McCaskill, 'Actions And Causes Of Action' (1924-25) 34 Yale Law Journal 614

\(^3\) Lon L. Fuller and William Perdue, 'The reliance interest in contract damages' (1936) 46 Yale Law Journal 52

\(^4\) Lon L. Fuller and William Perdue, 'The reliance interest in contract damages' (1936) 46 Yale Law Journal 52
normally incur court costs on the promisee seeking contract remedies. If the promisee relies on the contract law system, the promisor can exploit bad law by capturing interests that are not ‘assured’ by contract law, or he can exploit court costs by capturing interests the values of which are lower than the court costs to obtain damages, or strategically invest in the court process to tilt the bargaining table.

The merchant law system also does not fully protect the promisee from opportunistic contract behavior. The merchant law system incurs *ex ante* transaction costs, which include the costs of being active in business networks and monitoring performance.

For instance, to rely on internal sanctions, the promisee must first select promisors who internalize norms. To rely on private sanctions, the promisee must first procure

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85 This point has been the key issue in the frivolous lawsuits literature. For example, see Lucian Arye Bebchuk and Howard F. Chang, 'An analysis of fee shifting based on the margin of victory: or frivolous suits, meritorious suits, and the role of rule' (1996) 25 *Journal of Legal Studies* 371; Amy Farmer and Paul Pecorino, 'A Reputation for Being a Nuisance: Frivolous Lawsuits and Fee Shifting in a Repeated Play Game' (1998) 18 *International Review of Law and Economics* 147

86 Peter Bardsley and Quan Nguyen, 'Rent-seeking and judicial bias in weak legal systems' (Working paper, Melbourne University Economics Department and Law School, 2004) (On file with author)

87 For my discussion of how business networks emerge in the Vietnamese market and how local merchants remain active in business networks, see Chapter 7

88 See, for example, Janet T. Landa, 'A Theory of the Ethnically Homogeneous Middlemen Group: An Institutional Alternative to Contract Law' (1981) 10(2) *Journal of Legal Studies* 349 (suggesting that Chinese middlemen prefer to do business with those coming from the same ethnic group, that is, internalizing the same norms); L. Bernstein, 'Opting out of the Legal-System - Extralegal Contractual Relations in the Diamond Industry' (1992) 21(1) *Journal of Legal Studies* 115 (suggesting that Jewish religion matters because Jewish diamond merchants tend to select middlemen from the Jewish community and are restrained from bringing disputes among themselves to court because it is inconsistent with Jewish religious norms)
private power or build up inter-locking relations with promisors.\(^{89}\) To rely on reputational sanctions, the promisee must first select those who have a reputation to loose in the market, and there must be mechanisms to disperse bad information about those who behaves opportunistically in the specific market or industry in which the promisor is active.\(^{90}\) More generally, because the merchant law system is a private institution, the promisee has to invest in setting up, maintaining, or functioning within the institution. If the promisee relies on the merchant law system, he or she may not be able to capitalize on transaction costs invested *ex ante* if the promisor does not behave opportunistically, or regret contingencies do not arise.

These imperfections in the two contract ordering systems can make either party to the contract vulnerable to exploitation by opportunistic contract behavior. If the promisee

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\(^{89}\) See Chapter 7. See also Janet T. Landa, *A Theory of the Ethnically Homogeneous Middlemen Group: An Institutional Alternative to Contract Law* (1981) 10(2) *Journal of Legal Studies* 349 (To be the relational institution that supports exchange, kinship must precede contractual relations)

\(^{90}\) Empirical studies of informal commercial practices and private ordering suggest that the efficacy of reputational sanctions varies according to different market structures and different trade occupations. Compare, for examples, L. Bernstein, *Opting out of the Legal-System - Extralegal Contractual Relations in the Diamond Industry* (1992) 21(1) *Journal of Legal Studies* 115 (discussing the mechanisms of reputational sanctions and market structures in the diamond industry in the United States) with {Bernstein, 2001 #506} (discussing the mechanisms of reputational sanctions and market structures in the cotton industry in the United States). In these two industries in the United States, market structures differ. In the diamond industry, commercial norms are learnt and practiced by Jewish diamond dealers without the aid of formal arbitration, associations or charters, which, to the contrary, play a key role in enforcing commercial norms in the cotton industry. Also compare Lisa Bernstein’s above-mentioned works with, for examples, {McMillan, 1999 #253; McMillan, 1999 #270}; or {Greif, 1989 #560}. The social structures that enforce commercial norms by inflicting reputational sanctions in the Vietnamese market (discussed by McMillan and Woodruff), among the Medieval Maghribi traders (discussed by Grief), or in the diamond industry and the cotton industry in the United States (discussed by Bernstein) are not the same
stays in the market long enough, the promisor may learn whether the promisee relies exclusively on the contract law system or the ‘merchant law’ system to support contractual arrangements. The opportunistic promisor then may take advantage of this information, as indicated before. If the promisee employs a mixed strategy, that is, reliance on both the contract law system and the ‘merchant law’ system, this strategy can eliminate incentives for opportunistic contract behavior.

On the other hand, a mixed strategy of contract governance may increase transaction costs. The ‘merchant law’ system incurs *ex ante* costs of setting up and functioning private institutions. The formal contract law system incurs *ex post* costs of, for example, hiring lawyers to draft a contract in the language that the court would recognize and enforce. A mixed strategy may incur both *ex ante* costs of setting up private institutions and *ex post* costs of legal drafting.

A hypothetical story illustrates the relationships between opportunism, transaction costs, and incompatible contract ordering systems in the Vietnamese market. QG and SD are two companies in the Vietnamese market. SD owns a factory in Vinh Long in the Mekong Delta, where land and wages are relatively cheaper than in Ho Chi Minh City, to produce educational toys for children. QG is a trading company in Ho Chi Minh City that distributes educational toys to toy shops, gift shops and primary schools. QG buys toys and gifts from producers in the Mekong Delta to keep the price low. The two companies want to enter contractual arrangements by which SD would produce toys that QG orders in a certain quantity for the latter to supply to shops and

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91 See Chapter 7

schools in Ho Chi Minh City. At a very early stage of the trading relationship, both would need to work out how they are going to arrange their transaction. Should they choose to rely on the ‘merchant law’ system or the formal contract law system to economize on transaction costs and to prevent opportunistic contract behavior?

QG maximizes profit by expanding the clientele to increase sales volume. The sales volume is, however, not always predictable. In the market, new toy shops open, old toy shops close, primary schools buy when they want to have new toys with new designs, or to replace old toys, and there is fierce competition among toy suppliers. To maintain a reputation as a trustable toy supplier, QG wants to have toys delivered from SD according to orders of good quality, the right quantity and in a timely manner to meet its commitments with toy shops and primary schools in Ho Chi Minh City.

SD maximizes profit by optimizing the production of the factory. Producing toys requires skilled labor, which requires time for training, and specialized machinery, which requires initial investment and time to depreciate. Hence, SD wants to have orders long in advance and in a stable quantity that come close to the optimal production output of the factory. This is, however, not always attainable, because toy suppliers like QG tend to push for delivery in a short period when they have orders from toy shops and primary schools. To maintain the optimal production of the factory, SD may have to delay orders or compromise the quality of products when the total order is beyond the optimal production output.

Consider the situation when QG wants to order a large shipment to be delivered one month before Christmas, when toys are in high demand as gifts for children. At the time QG and SD arrange the transaction, it is reckoned that both sides will make a
profit and, in particular, QG values performance at $2000 in terms of profit. During performance and near Christmas, however, SD receives another order from another toy dealer. If SD accepts this order, SD would gain $1000 more in profit, but would certainly breach the promise made to QG. To maximize profit, SD may want to delay QG’s order until after Christmas in order to produce for the second order. But such a delay would cause QG to loose the anticipated profit of $2000.

As analyzed in the previous section, the high cost of transfer of contractual arrangements between two ordering systems in the Vietnamese market tends to induce merchants to stay in one ordering system and to ignore the other. To decide whether to arrange the transaction within the ‘merchant law’ system or the formal contract law system, QG would need to consider the transaction costs of the two systems. Recall that commercial wisdom would follow backward induction in the selection of institutions, QG would try to predict which contract ordering system is more effective to prevent opportunistic contract behavior when regret contingencies arise.

Following the concept of backward induction, let us first consider the situation if QG chooses to arrange the transaction within the formal contract law system. Let us assume that the *ex post* costs of the formal contract law system, which are the cost of formal legal drafting and the cost of the legal process, are $500 and $2000 consecutively. If SD breaches the promise to deliver the shipment, QG may want to bring SD to court. But because court cost equals the anticipated profit, which is also the contractual damage that QG can expect from the court, QG would not start the legal action because it is just a waste of time. The outcome in this situation would be that QG loses $500 in formal legal drafting of the contract, while SD gets $1000 more in profit from the second order. If SD rejects the second order to honor the promise to
QG, SD loses $1000 in increased profit from the second order, while QG can sell the shipment and get $2000 in profit minus $500 cost of legal drafting.

Now let us consider the situation if QG wants to arrange the transaction within the ‘merchant law’ system. Let us assume that the *ex ante* investment of QG to maintain the effectiveness of informal enforcement mechanisms is $1000. If SD breaches the promise, QG would lose $2000 in anticipated profit plus $1000 of *ex ante* investment. However, SD’s future deals with QG are lost. SD also loses deals with other toy dealers in the market as a result of network sanction and loss of reputation as a trustworthy producer. Despite SD getting $1000 more in profit from the second order, SD values future deals with QG and loss of reputation at $4000. As a result, SD loses $3000 in the value of future orders.

The contractual arrangements are illustrated as a sequential-play game in Figure 3 in the Appendix.

Still following the concept of backward induction, the best strategy for QG is to incur *ex ante* investment in the ‘merchant law’ system and to arrange the transaction within the ‘merchant law’ system. If QG chooses to arrange the transaction within the ‘merchant law’ system, the huge loss of future deals and reputation would induce SD to honor the promise to deliver the shipment to QG before Christmas. In this hypothetical story, given the context of the Vietnamese market, QG would try to arrange transactions with SD within the ‘merchant law’ system and ignore the formal contract law system.

It is important to note here that the sole reliance on the ‘merchant law’ system may increase the transaction costs of contractual arrangements in the Vietnamese market.
Recall that the ‘merchant law’ system in the Vietnamese market incurs ex ante investment in setting up and maintaining enforcement mechanisms, which is a kind of transaction cost in the market. Ex ante investment is not recoverable, irrespective of whether regret contingencies arise or not, and therefore reduces the profit of market players. As it is illustrated in the hypothetical story, merchants would choose to arrange their transactions within the ‘merchant law’ system, which is a more expensive way of doing business, because the formal contract law system also incurs transaction costs (which include the costs of the legal process to seek contractual remedies). However, as will be discussed in the following section, the effectiveness of the formal contract law system to support contractual arrangements depends not only on the costs of obtaining contractual remedies through the legal process, but also the predictability of the judicial outcome.

5. IF RELIANCE ON THE ‘MERCHANT LAW’ SYSTEM INCURS EX ANTE INVESTMENT AND ONGOING COSTS, IS IT BETTER TO RELY ON THE FORMAL CONTRACT LAW SYSTEM?

My analysis of how merchants select between the ‘merchant law’ system and the formal contract law system assumes that they do so to pursue wealth maximization. On this assumption, it follows that merchants choose to arrange their transactions within the ‘merchant law’ system because it serves their purpose better than the formal contract law system. Indeed, as illustrated in the hypothetical story of QG and SD, the ‘merchant law’ system may actually increase transaction costs of contractual arrangements in the market. It requires ex ante investment to set up and to maintain private enforcement mechanisms. It does not allow the promisee to recover these investment, no matter whether the promisor is opportunistic or not. It also does not
allow the promisee to recover reliance costs and anticipated profits when the promisor behaves opportunistically.

In contrast, the formal contract law system does not require *ex ante* investment. Costs are only incurred when regret contingencies arise and the promisor behaves opportunistically. If the regret contingencies are incurred and the promisor does behave opportunistically, contractual remedies can still offer some relief, if court costs are not so high that it is not worthwhile to attempt to seek contractual remedies in the court. If it is only court costs that keep the promisee away from the court process, then this would explain only why small value transactions are not arranged within the formal contract law system. This does not explain why many transactions that involve large value of money are not arranged in the formal contract law system to save *ex ante* investment and to seek contractual remedies against opportunistic contract behavior.\(^{93}\) Compared with my observation about the dominant role of the ‘merchant law’ system in the Vietnamese market, there needs to be further explanation as to why the formal contract law system, borrowed from developed Western legal systems, is so insignificant in real life contractual arrangements in Vietnam.

This section demonstrates that merchants avoid arranging their transactions in the formal contract law system not only because of real costs of the court process, but because the system may actually increase uncertainty and encourage opportunistic contract behavior. The real cost of the court process is a contributory factor, but not

\(^{93}\) This point is related to the case of Thai Vinh Truong, discussed in Chapter 4, where transactions valued in many hundred thousands of U.S dollars were not evidenced according to the formal contract law system
the main factor explaining the unattractiveness of the system. When court costs are combined with inconsistency in contract laws and the incapacity of judges, the formal contract law system may function as an institution that increases uncertainty in the market, rather than one that reduces uncertainty. Recall that uncertainty is the main problem in contracting, a formal contract law system that increases uncertainty in the market would certainly fail to support contractual arrangements. For this reason, it is claimed that merchants choose to arrange their transactions within the ‘merchant law’ system rather than the formal contract law system, because they are willing to pay a higher price for certainty in their contractual arrangements.

As in the previous section, this section also uses the concepts of game theory to analyze the behavior of merchants when they bring their contractual arrangements into the formal contract law system. The ‘bargaining in the shadow of the law’ theory is adopted enabling an assumption that how merchants behave in their conflicts of economic interests in contractual relationships depends on how they expect the court would allocate these economic interests.

I run a hypothetical court based on the generic formula of courts. Legal disputes are defined as inconsistent claims over legal entitlements. The main function of courts is to verify the merit of inconsistent claims over legal entitlements in legal disputes.


95 It is submitted that since the introduction of regular courts in human societies, the main role of courts is to apply ‘laws’ to verify inconsistent claims in disputes. ‘Laws’ in the early history of regular courts may primarily comprise of ‘traditional customs which have been handed down by oral tradition from
To verify inconsistent claims over legal entitlements, courts need to analyze information relevant to the dispute.\textsuperscript{96} The court process is designed in the way that relevant information can be revealed and processed. The court’s decision depends on the information courts have, and the competence of courts in verifying inconsistent claims based on relevant information. Naturally, the more information courts have, and the more competent courts are, the more precisely courts can apply laws to adjudicate the legal dispute. The costs of running the court process consist of the costs of making relevant information available to the court, and the costs for the court to process information.\textsuperscript{97} I analyze how this court influences contractual behavior by applying behavioral theory, on the assumption that players maximize their utility. The following story is based on this generic formula.

Assume that two persons Jack and Jim stumble on the street and find between their feet a 100-dollar note, which has dropped out of Jack’s pocket. There is no witness.

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\textsuperscript{96} Peter Stein, \textit{Legal institutions: the development of dispute settlements} (1984) at 14 (Stein describes the role of courts in verifying inconsistent claims over legal entitlements – what he called ‘classical model of the legal process’ – as follows: ‘first, that the whole law is declared in a set of known rules of reasonable precision: secondly, that they will be applied to any conceivable set of facts so as to produce decisions that can be predicted with confidence: and thirdly, that those decisions will be based exclusively on the application of rules to the ‘relevant’ facts and will be totally insulated from ‘irrelevant’ circumstances that may affect the parties’. In general, ‘facts’ can be any information relevant to the dispute.)

\textsuperscript{97} For example, the costs of making information available to the court may include (but not exclusively) lawyers’ fees, costs to produce evidence or non-monetary costs such as time costs, opportunity costs. See James M. Buchanan, \textit{Cost and Choice: An Inquiry in Economic Theory} (1969). The costs for the court to process information may include but not exclusively labour costs of the judges and members of the jury if any
They would usually assert claims on the note, negotiate, and, if negotiation fails, go to court. At the first stage, each person can (1) claim the note, or (2) leave the note to the other. Conventional models of resolution of legal disputes say that Jack expects to have 100-dollar note less his court costs if he believes both that the note comes out of his pocket and that the court will give justice.98

The resulting dispute resolution game is demonstrated in the table in Figure 4 in the Appendix. In this game, the payoffs are not determined yet, because they depend on how the court is to resolve the dispute. The following section discusses how the court process influences the disputants’ behavior.

*Model One – Incompetent courts with zero court costs*

Imagine that Jack and Jim standing outside the door of the court. Inside sits a judge awaiting disputes to resolve without charge. However, neither person knows how the judge will decide, because the judge is unpredictable. Assume that Jack predicts that with probability \( p \) the judge is on his side; Jim predicts that with probability \( d \) the judge is on his side. If either person walks away, the other takes the note. If both leave, a beggar takes the note. This game is demonstrated in Figure 5 in the Appendix.

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98 Robert Cooter and Daniel Rubinfeld, 'Trial courts: An economic perspective' (1990) 24 Law & Society Review 533, at 536 discussing the expected payoff of a claimant from pressing a claim ‘depends upon the possible outcomes of settlement bargaining and, in the event bargaining fails, of a trial. Thus, the expected payoff from pressing a claim is affected by legal rules that allocate litigation costs, assign the burdens and standards of proof, and specify the basis for computing damages’
In this game, Jack finds a dominant strategy. He always claims the note. If Jim wants to claim the note too, both go to court, and Jack expects to get $p$ out of the court. If Jim walks away, Jack gets all his money back. Any claim is better than walk-away, because then Jack surely loses his note. So Jack always claims the note. Jim has a dominant strategy too. Looking at the game, Jim probably expects that Jack would always claim his note. But Jim expects that if both go to court, he may get $d$, better than the zero he will get if he walks away. Therefore, Jim also always claims the note. The result is that both persons claim the note, and both persons go to court. We end the story here, because the judge is unpredictable.

This model argues that when courts are incompetent in verifying inconsistent claims over legal entitlements, legal disputes arise because parties have different expectations as to how their legal entitlements will be recognized and secured by courts.\(^99\) In this situation, legal disputes may arise despite the fact that there is no cost in using the court process to resolve legal disputes.

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\(^{99}\) I am aware of one paper that discusses this phenomenon, which is Richard H. McAdams, 'A focal point theory of expressive law' (2000) 86 Virginia Law Review 1649. In the course of discussing his ‘expressive theory of law’, McAdam suggested that adjudication based on randomisation of alternative options instead of the merit of claims could create incentives for claims without merit. McAdam came across this phenomenon when he was discussing the pro and con of his proposition of an expressive theory of adjudication, in which the role of courts is not to resolve legal disputes by imposing state-backed sanctions, but to mediate disputants by pointing to a focal point for disputants to coordinate to find an optimal solution for themselves. However, McAdam only mentioned the phenomenon in the course of his argument without explaining it theoretically. Moreover, McAdam is internally inconsistent in his theory of expressive adjudication. He wrote: 'In addition to the focal point effect, fact-based adjudication also works expressively by providing the players with information to update their prior beliefs. If the judge were though to be sufficiently reliable in ascertaining the facts, then the signal would always cause the “losing” player to believe he was not the processor. Given his strategy, the losing player will then play Dove’. See Ibid at footnote 113. But the nature of adjudication by the focal point effect means that the judge would never be ‘reliable in ascertaining the facts’, which
Imagine that the court is competent. Like Solomon, the judge can verify exactly whose note it is. But his labor is not without charge. Each person has to pay $k$ for the dispute to be heard. This game is demonstrated in Figure 6 in the Appendix.

In this game, whether Jack wants to claim his money back depends on how much the judge charges him to hear his case. I examine two situations: first, where the court cost is smaller than the value in dispute; and second, where the court cost is higher than the value in dispute.

If the charge $k$ is less than his note, Jack has a dominant strategy again. He always claims his note back. If Jim disputes, both go to court, the court charges Jack $k$, but he gets his note back and this outcome still better than loosing everything if he walks away. So Jack will always claim his note.

Jim probably expects that Jack always claims his note. If both go to court, the court will charge Jim $k$ too. But Jim will get nothing from the judge. So it is better for Jim to walk away in order not to pay the charge.

\[\text{Model two: competent courts and considerable court costs}\]

McAdam argued to be the sufficient condition for the focal point effect of adjudication. It comes to the question of 'chicken and eggs': which existed first?

\[\text{100 King Solomon was a legendary king of the Jews. One day, two women gave birth, but one of the babies died soon thereafter. Both women claimed the living infant was theirs. There is no witness and no evidence to prove whose baby it was. Only the women themselves know whose baby it was. The women appealed to King Solomon. The King offered to cut the baby and give each woman half of it. One woman agreed, while the other declined and stated she would rather have the baby given to her rival than have it die. King Solomon then decreed that the latter woman was the real mother, and awarded the baby to her. 1 Kings 3:16-28. This story is told to demonstrate that the truth can often be found at very little cost}\]
If the charge $k$ is more than the note, neither person has a dominant strategy. Clearly that Jack wants to claim his note. But his claim is worthwhile only if Jim then walks away. If both persons claim the note, they go to court, and both lose something. The judge charges Jack $k$, which is more than the value of the note. And Jim has to pay $k$ too. So Jim is better off walking away. But Jim has incentives to be greedy. He knows that Jack does not want to go to court. So why not claim? At least, they can still negotiate at the court door. If Jack then compromises, Jim can take the note.

There is no hard-and-fast answer to this game, where the cost of using the court process $k$ is more than the value in dispute. But we know that if the court process is costly to verify inconsistent claims over legal entitlements, there are both positive and negative effects on legal disputes. If the cost is less than the value in dispute, and paid by both sides in the dispute (that is, plaintiff and defendant pay their own court costs no matter whether they win the case or not), it strongly discourages opportunism. The cost then serves as a punishment for those whose claim is without merit. But if the cost is more than the value in dispute, it strongly encourages opportunism, especially when disputants have chance to bargain during the court process. In that situation, legal disputes are usually resolved by a different game: bargaining within the court process.

*Model three: incompetent courts and considerable court costs*

Again, we assume that Jack and Jim have different expectations about how the judge will resolve their dispute. Jack expects to get $p$ from the judge, and Jim expects to get $d$. For these expected outcomes, each person still has to pay the court $k$. This game is demonstrated in Figure 7 in the Appendix.
In this game, whether Jack wants to claim his money depends on how much the court charges him for his claim. If the court charges him $k$, less than what he expects to get from the court, Jack has a dominant strategy: he always claims his money. If Jim disputes, they go to court, and Jack still gets something positive out of the judge.\footnote{If the court charges Jack less than what he expects to get, and charges Jim more than what he expects to get, Jack always claims. Knowing that Jack always claims, Jim walks away to avoid court costs.}

Any claim is better than walking away and losing the note to Jim.

Jim may also has a dominant strategy, depending on how much he expects to get from the judge, and how much the court charges him. If the court charges him less than what he expects to win, Jim always claims too.\footnote{If the court charges Jack more than what he expects to get, and charges Jim less than what he expects to get, Jim always claims. Knowing that Jim always claims, Jack walks away to avoid additional court costs.} Both persons then go to court. The result is that both find themselves in court.

The game becomes more complicated when the court charges more than what it is expected to give.

- If the court charges Jack less than what he expects to get, and charges Jim more than what he expects to get, Jack always claims. Knowing that Jack always claims, Jim walks away to avoid court costs.
- If the court charges Jack more than what he expects to get, and charges Jim less than what he expects to get, Jim always claims. Knowing that Jim always claims, Jack walks away to avoid additional court costs.

\footnote{In mathematics: $p > k \Rightarrow p - k - 1 > -1$, Jack fares better going to court with Jim than walking away to let Jim take the note}

\footnote{In mathematics, $d > k \Rightarrow d - k > 0$, Jim expects to get something out of the court}
If the court charges both persons more than what they expect to win, again Jim has incentives to be opportunistic. Both don’t want to go to court. Therefore, they negotiate to resolve their dispute at the door of the court.

This model tells us that disputants are concerned not only with how much it costs to use the court process to resolve disputes, but also how competent the court is to verify inconsistent claims over legal entitlements. If courts usually make bad judgments, they discourage meritorious claims. But that does not mean that there are less legal disputes because opportunistic claims are encouraged. In the game, for example, Jim is probably pleased to find that the judge can make very bad decisions, which gives him more incentive to be opportunistic. And there is also interrelationship between poor legal institutions and high cost. This interrelationship will be discussed in another part of this thesis.

Model four: efficient courts with no court costs

We now discuss legal disputes if the court is perfectly competent. I assume here that the judge always makes correct decision, and even better, does so at no charge. This game is demonstrated in Figure 8 in the Appendix.

In this game, Jack has a dominant strategy. He always claims his note back. If Jim disputes, nothing stops Jack from going to court. The judge is there, and he makes good decision without charge. Knowing all this, Jim has no incentive to dispute,
especially if he is pressed for time and does not want to stop to quarrel, or does not want the court to say that he is a liar.\textsuperscript{103}

These analyses support the claim that the ‘bargaining in the shadow of the law’ can increase uncertainty and encourage opportunistic behavior in the market. This is contrary to the common assumption that the legal process is perfect, fair and immediate.\textsuperscript{104} In the above models, especially models two and three, expensive and inconsistent courts may encourage opportunism. Disputants may strategically invoke the court process in a bargaining game to pursue wealth maximization. The bargaining strategies of disputants depend on the value in dispute, the cost of using the court process and/or the competence of courts in verifying inconsistent claims over legal entitlements. My analysis here provides a theoretical explanation of why incompetent courts create rather than resolve disputes, using rational choice theory.

In addition, the bargaining strategies of disputants also depend on the integrity of the judge. Although this chapter does not examine the situation where the judge is intrinsically biased, or corruptible, in practice judges are far from perfect.\textsuperscript{105} In

\begin{quote}
\footnotesize
\textsuperscript{103} This assumption takes into account the broader conception of utility, which comprises not only monetary utility, but also non-monetary utility. See, for example, Herbert M. Kritzer, \textit{Let's Make A Deal: Understanding The Negotiation Process In Ordinary Litigation} (1991)
\end{quote}

\begin{quote}
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\textsuperscript{104} This assumption is particularly popular in the law and economics analysis of legal disputes and settlement. A very good review of this literature can be found in Robert Cooter and Daniel Rubinfeld, 'Economic analysis of legal disputes and their resolution' (1989) 27(3) \textit{Journal of Economic Literature} 1067
\end{quote}

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\textsuperscript{105} Judicial rent-seeking is not new, usually thought of as corruption within the court system, but many law and society scholars, especially those doing research on developing Asian legal systems, see the issue as an intrinsic problem of the system, due to the conflict between relational institutions and the ‘rule of law’. See, for example, Tim Lindsey, ‘History Always Repeats? Corruption and 'Asian Values" in Tim Lindsey and Howard Dick (eds), \textit{Corruption in Asia} (2002) 1
\end{quote}
another paper, professor Peter Bardsley and I examined the situation where judicial rent-seeking activities influence the outcome of the court process because the judge is biased or corruptible. We found that bargaining strategies significantly change when one party strategically invest in judicial rent-seeking activities to tilt the bargaining table.  

The second claim that the above analyses support is that the formal contract law system is not a perfect institution to solve the problems of contracting. While the theoretical model four (an unboundedly rational court with no court costs) can increase certainty in the market, such a court is unlikely to exist in real life markets. All other models come close to real life courts and may worsen the problem of incomplete information, as well as encourage opportunism in the market. More specifically, the more costly court ordering is, and the more unpredictable the court is, the more incomplete information is in the market and the more opportunistic merchants can be.  

There is no guarantee that the formal contract law system, manifested in the way the court administers the law, is superior to private ordering of the ‘merchant law’ system; and there is no guarantee that the formal contract law

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106 Peter Bardsley and Quan Nguyen, 'Rent-seeking and judicial biased in weak legal systems' (Working paper, Melbourne University Economics Department and Law School, 2004) (On file with author)

107 If the promisee is uncertain about the costs of using the court process, the competence of courts in verifying inconsistent claims, the value in disputes, and the integrity of the judge, he/she cannot predict promisor’s course of action regarding future exchange if he/she relies solely on court ordering to support the transaction. As a consequence, court ordering may fail to support the planning of exchange into the future. In addition, reliance on court ordering in this situation would increase the measurement costs in ex ante norm-setting and the enforcement costs in ex post execution, and therefore fails the purpose of contracting to economize on transaction costs.
system can help resolve the problems of contracting more efficiently than the merchant law system.

In addition, as discussed in Chapter 5, the imperfect model of the court process is a good way to describe the court process in the Vietnamese market. Contract laws introduced at different stages of economic reform are inconsistent among themselves.\textsuperscript{108} Interpretation of the law does not follow precedents, while jurisprudence of market-based commercial laws is underdeveloped.\textsuperscript{109} The bureaucratic process of drafting laws and the tendency to borrow foreign commercial laws make it difficult for judges and lawyers to interpret laws according to the intention of the law makers.\textsuperscript{110} Bias and corruption are not absent in the court process.\textsuperscript{111} All these factors contribute to uncertainty of outcomes in the legal process. Uncertainty undermines the formal contract law system as an institution to solve the problems of contracting. This analysis of the court process explains why, in general, merchants tend to avoid arranging their transactions within the formal contract law system.

6. \textsc{Towards a Theory of Contract Governance}

This chapter explains the relationships among contract law, the social structure of the market, and contractual arrangements. It analyses observation and facts of contract practice in the Vietnamese market by reference to the larger literature on contract. It

\textsuperscript{108} See Chapter 5

\textsuperscript{109} See Chapter 5

\textsuperscript{110} See Chapter 5

\textsuperscript{111} See Chapter 5
uses the theoretical framework of institutional law and economics and behavioural theory. The analyses in this chapter support the following propositions:

First, the incompatibility between the ‘merchant law’ system and the formal contract law system in the Vietnamese market can increase transaction costs and opportunistic behaviour in contractual arrangements in this market. More specifically, incompatibility between the two ordering systems worsen the incompleteness of information in contracting, and creates more incentives for opportunistic behavior. As a result, this incompatibility reduces the effectiveness of the formal contract law system in supporting contractual arrangements in the market.

Secondly, the cost of transfer of contractual arrangements between the two contract ordering systems and the profit margin in the market are responsible for the marginalization of the effect of the formal contract law system in real life contractual arrangements. Where the cost of transfer is high, merchants would expand more resources to arrange their transactions so that they will not have to transfer their contractual arrangements between the two contract ordering systems.

Further, inconsistence in contract laws and unqualified judges are the main reasons that make the formal contract law system ineffective in providing an institutional structure to solve the problems of contracting. Hence local merchants may avoid this ordering system to arrange their transactions within the ‘merchant law’ system, despite the fact that it may increase transaction costs.

Finally, real life contractual arrangements can be described as an institutional model. Exchange of promises in contracting is the setting of norms to project an exchange into the future. Contract governance is the task of enforcing norms set in contracting
with minimum transaction costs. Institutions (either the legal system or relational institutions) can support contracting by providing default norms to reduce drafting costs and incentive structures to enforce norms set in contracting. Contracting parties select from compatible default norms and incentive structures in the market for the purpose of economizing on transaction costs.

This model explains the relationships among contractual arrangements, the institutional structure of the market, and the formal contract law system. On the one hand, it recognizes that a contract as not only a set of legal rights and obligations, but also part of the relationship between contracting parties. On the other hand, it explains the ‘opting-out’ syndrome in contracting,\footnote{L. Bernstein, ‘Opting out of the Legal-System - Extralegal Contractual Relations in the Diamond Industry’ (1992) 21(1) Journal of Legal Studies 115 \textlangle Go to ISI\rangle://A1992HP64800005 \textrangle} which is actually the consequence of the selection between relational institutions and the legal system to support exchange. In addition, it suggests that formal court ordering and relational ordering does not function to exclude each other. Whether these two ordering systems are incompatible or not depend on their norms. If legal norms are drafted consistently with merchant’s norms in the market, the institutional structure of the formal contract law system can actually strengthen the institutional structure of the ‘merchant law’ system, and vice versa. Therefore, this proposition rejects the popular assumption in the private ordering literature that relational institutions may substitute court ordering. Indeed, there is the possibility that court ordering and relational institutions may function collaboratively.
CONCLUSION

At the start of this thesis a key question was posed: How should a contract law system be constructed to support market transactions in the Vietnamese market? To answer this question, it is necessary to understand how contract law reform influences real life contractual arrangements. The materials presented in this thesis enable the understanding of this sophisticated relationship between contract law reform and real life contractual arrangements at two levels: within the context of the Vietnamese market; and in a general context of markets where similar institutional structures exist. Moreover, this thesis provides insights into the relationship between contract law reform and institutional changes in the market, and how institutional changes affect real life contractual arrangements. As a result, this thesis challenges current assumptions underpinning contract law reform in Vietnam.

1. INSIGHTS INTO CONTRACT PRACTICES IN THE VIETNAMESE MARKET

This thesis modifies both the formalists’ ‘bargaining in the shadow of the law’ assumption and the relationalists’ standard repeated-game story of real life contractual arrangements. The role of contract law in real life contractual arrangements in the Vietnamese market, this thesis argues, is marginalized by the existence of a merchant law system, influenced by basic Confucian morality and enforced by traditional social structures. This merchant law system, the thesis argues, ordered exchange relationships in the traditional Vietnamese market and is still doing so in its modern equivalent. The newly introduced formal contract law system which has been largely transplanted from
foreign legal systems does not conform to the merchant law system in the market. As a consequence of market selection and the cost of transfer of contractual arrangements between the two ordering systems, the formal contract law system has, in fact, little effect in framing real life contractual arrangements in the modern Vietnamese market.

2. IN A GENERAL CONTEXT OF THE MARKET

Although a merchant law system that features basic Confucian morality may be a characteristic of the Vietnamese market, the institutional structure of the merchant law system in Vietnam can be found in some other markets. These are markets where contracting parties share a set of relational norms that guide their conduct in exchange, and there are incentives embedded in the social structures in the market that enforce relational norms. Bernstein found similar institutional structures in the diamond market in the United States among Jewish diamond dealers.¹ Landa likewise found relational institutions that substitute contract law in the rubber market in Southeast Asia among Chinese rubber small dealers.² Milhaupt and West found that criminal gangs in Japan can supply private ordering that is used by many local merchants to resolve commercial disputes.³ This evidence of similar institutional structures in other markets suggests that

the lessons learnt from how institutional structures in the Vietnamese market influence contractual arrangements may have implications in a more general context.

In the general market context, the role of contract law in real life contractual arrangements depends on the institutional structure of the market. If there is no existing institutional structure in the market that is capable of ordering exchange relationships, then contract law is the framework of contractual arrangements for merchants to economize on transaction costs. But if there exist social structures in the market that are capable of providing an institutional structure to order exchange relationships, that is, there is a set of popular norms that guide conducts in exchange relationships, and incentive structures to enforce the norms, then the role of contract law depends on the cost of transferring contractual arrangements between the two ordering systems and the selection of the market.

If there is no cost of transfer, that is, if the formal contract law totally conforms to the merchant law system or vice versa, then the ‘bargaining in the shadow of the law’ theory applies to contractual arrangements. If the cost of transfer outweighs the profit margin of the market, there will be selection between the two ordering systems and contract law will have a marginal effect in ordering contractual arrangements. Selection between the two ordering systems increases the transaction costs of contracting. However, where there are established social networks to circulate information in the market, market selection may keep contractual arrangements within the single framework of the traditional ordering system in the market.
The merchant law system becomes the dominant framework for contractual arrangements. If it is costly to transfer between ordering systems and it is comparatively more efficient to use the contract law system (i.e., because of a lack of either popular relational norms for exchange relationships, or incentive structures to enforce relational norms), then arguably market selection will result in the selection of the contract law system as the dominant ordering system in the market.

3. A THEORETICAL CHALLENGE TO “CLASSIC” CONTRACT LAW REFORM

Alternative agendas for contract law reform suggested here for the Vietnamese market are constructed on the following four propositions. The first two propositions derive from new institutionalism, mainly as explained in the works of North. The second two propositions have been established during the investigation of this thesis. These four propositions generate a theoretical framework for proposed agendas of contract law reform.

The first proposition is that institutions are imperfect. The imperfection of institutions lies in the limits of human cognitive power and the nature of institutions as constraints on human conducts. Limited human cognitive power makes it costly for human beings to learn about and to follow the constraints of institutions. Institutions as constraints reduce the liberty of choice, the cost side of which may, in many circumstances, outweigh the benefit side of reducing uncertainty in human interactions. It follows that both the merchant law system and the contract law system are costly to use to solve the problems of contracting. However, this proposition makes sense of attempts to reform the
institutional structure of the market, so as to reduce transaction costs of market players to learn about and to follow institutional constraints in their daily contractual arrangements in order to facilitate exchange.

The second proposition is that the institutional structure of the market changes incrementally and is path-dependent. Nevertheless, there is a reservation regarding contract law reform. In the Vietnamese market, while the merchant law system changes incrementally and is path-dependent, contract law reform has introduced a new contract law system in the market over a relatively short period of time. Because the institutional structure of the market is constituted by both the contract law system and the merchant law system, accelerated change in the institutional structure of the market can be achieved by way of contract law reform. This justifies contract law reform as a desirable instrument of institutional reform.

The third proposition is that market selection is a determinant factor in introducing a new contract law system into real life contractual arrangements. It follows that the agenda of contract law reform must be ‘sold’ to, rather than imposed on, the market if it is going to take effect in real life contractual arrangements, particularly given effective competition from the ‘merchant law’ system.

The fourth proposition is that there is a cost of transfer of contractual arrangements between ordering systems. This cost of transfer is the key in guiding market selection. If the cost of transfer is lower than the profit margin of the market (that is, if formal contract law largely conforms to the institutional structures of the market), then contract law provides the ultimate framework for contractual arrangements in the market. If the cost of
transfer is higher than the profit margin in the market, then market selection is the only way to bring contract law into real life contractual arrangements. This can happen if there is a substantial change in the population of merchants in the market, so that the majority of the market selects to arrange their contractual relationships in the shadow of the law, thus inducing new entrants to do the same.

4. IMPLICATIONS FOR THE CONTRACT LAW LITERATURE

One of the important contributions of this thesis to contract law literature is providing a way to map institutional matrices. Mapping the institutional matrix of a market has been an impasse for the application of the relational contract theory in developing a normative theory of contract law. In the Vietnamese market, tracing institutional changes allows us to map out a merchant law system which features the traditional Confucian morality of the market. In the absence of state-sponsored market institutions, social structures in the market substitute for the law to function as enforcement mechanisms for merchants’ norms. Even after a contract law system has been introduced into the market, the Confucian-style ‘law merchant’ still prevails as an evolutionary-stable strategy for market incumbents and new market entrants. Traditional moral norms thus serve as the framework of the institutional matrix of the Vietnamese market.

Contrary to the conventional assumption that the law is the ‘back-up’ system for market mechanisms, this thesis finds that the law may fail the market if not properly constructed. In particular, where legal norms differ significantly from market norms, it follows that enforcement mechanisms of the law do not recognize or enforce market norms. In this situation, the law does not ‘back-up’ market mechanisms, and contracting parties face
selection between the law and market mechanisms. A law that does not ‘back-up’ market mechanisms increases the problem of incomplete contracting as it is more difficult for contracting parties to predict the contract behavior of their counterparts. A law that does not ‘back-up’ market mechanisms also increases the problem of opportunism, because it induces contracting parties to ‘shop’ for a better outcome between the law and market mechanisms during ex post contract performance. If the law outlaws the ‘merchant law’ and market enforcement mechanisms, then the costs of mobilizing either the law or market mechanisms to enforce promises increase, because these two conflicting ordering systems can compromise each other. At worst, contract disputants cannot fall back on the court even after all market enforcement mechanisms are exhausted, because the court simply does not recognize and enforce merchant’s norms or the incentive mechanisms upon which the contracting parties constructed their transactions. At best, the court process serves as a bargaining chip for the real bargaining game that takes place in the shadow of the ‘law merchant’, not the contract law.

Challenges raised by this thesis lie in how to re-design contract law for Confucian markets. The main feature of relational contracting in a Confucian market is that local merchants popularly refer to business morality derived from basic Confucian morality as the basic ‘boilerplate’ contract upon which to construct their transactions. A modern contract law system borrowed from Western legal systems may not recognize this Confucian ‘boilerplate’ contract. Because rights-based contract law doctrines naturally induce adversarial approaches to contracting and resolving contract disputes, they conflict with the Confucian ‘boilerplate’ notions of harmony, reciprocity and trust. A contract law system that fails to recognize and enforce this Confucian ‘boilerplate’
contract may also fail to support the efficiency of the transaction, which is structured upon implicit Confucian ‘boilerplate’ terms.

The usual consequence is that local merchants select to structure their whole transaction around the ‘law merchant’ of the market. This selection of market institutions gives rise to the practice of informal, relational contracting. In a Confucian market like Vietnam, traditional social structures support relational contracting. However, it is not guaranteed that these social structures will evolve at the same pace as the market or that they will be flexible enough to support market transactions efficiently when the market expands and transactions become more sophisticated. Perhaps it is by embracing Confucian ‘boilerplate’ contracts in contract law doctrines, or, at least, by doing so initially, a contract law system can strengthen and even replace market mechanisms to enforce the ‘law merchant’ of the market.

5. A PROPOSED AGENDA FOR CONTRACT LAW REFORM IN VIETNAM

This thesis suggests that contract law reform in Vietnam should adopt a new agenda, which unifies the contract law system and adapts the contract law system to the institutional structures of the Vietnamese market. As analyzed earlier, an unified contract law system, that comes closer to the institutional structures of the Vietnamese market, would reduce transaction costs and discourage opportunistic behavior in the contractual arrangements in the market.

The task of unifying the contract law system should be based on the nature of contracting, that is, solve the problems of interpreting gaps in the contract and prevent opportunistic
behavior in order to achieve efficiency in planning an exchange into the future. It is therefore pointless to have different contract laws to regulate commercial contractual arrangements in the Vietnamese market. This thesis suggests that the Civil Code be developed to replace both the Ordinance on Economic Contracts and contract provisions in the Commercial Law. As discussed earlier, the Ordinance on Economic Contracts should be annulled as soon as possible, because its drafting approach does not support commercial contractual arrangements in the Vietnamese market. The current Commercial Law does not have a drafting process that can adapt transplanted contract provisions with relational contracting practices in the Vietnamese market. Developing a new commercial law is both time consuming and financially costly. A commercial law which is administered separately from the Civil Code also risks of being administered and enforced differently from contract provisions in the Civil Code, consequently increasing transaction costs and opportunistic behaviors in the market, as analyzed in Chapter 8. Building upon the provisions of the Civil Code to embrace commercial contractual arrangements helps to achieve a unified contract law system in less time and at less cost.

Adapting the contract law system to the institutional structures of the Vietnamese market can be achieved by both re-drafting contract provisions and changing the way the contract law is administered in courts. As discussed in Chapter 5, the drafting process of the Civil Code took into account empirical research into the social norms and informal practices of civil transactions in different regions in Vietnam at the time the Code was drafted. That bottom-up drafting approach arguably reduced the gap between formal
contract provisions and informal contract practice in the market. However, the scope of application of the Code was limited to regulate contractual arrangements for individual consumption purposes, but not commercial contractual arrangements. This thesis proposes that new contract provisions for commercial contractual arrangements should be incorporated into the Civil Code to be administered under the broader principles of the Civil Code on civil transactions. In addition, the bottom-up approach should also be strictly followed to draft contract provisions to regulate commercial contractual arrangements in the Vietnamese market. This approach is consistent with the unification of the contract law system proposed in the previous paragraph.

One may be concerned as to how Vietnamese law drafters can find social norms and informal practices in the Vietnamese market to draft contract provisions that come closer to the institutional structures of the market. However, the bottom-up approach of drafting law is not new. If one looks into the history of commercial law development in the United Kingdom, common law contract law developed through judges’ decisions. An old principle in the English jurisprudence is that ‘Judges must find common law’, which suggests that judges in deciding cases should find and apply common commercial practices rather than making policies. The drafting of the Uniform Commercial Code in

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5 Ibid at 1649
the United States also follows this bottom-up approach. Portuguese law drafters can also find commercial practices in the Portuguese market to incorporate into the law as English judges adopt the common law.

What of concerns regarding different approaches in making statutory laws in a civil law system vis-à-vis judge-made law in the common law system is that, briefly speaking, while English judges look at common practices in the Commonwealth market to find a solution for a specific contractual dispute before the court, Portuguese law makers look at common practices in their market to find the solution for a range of hypothetical contractual disputes. This difference would require that contract provisions for the Portuguese market be drafted broadly as principles, in order to give judges who administer the law the flexibility necessary for the application of the law in specific contractual arrangements, which may differ in detail from the hypothetical situation that law drafters imagine when they draft the relevant provision.

This approach to drafting contract provisions for the Portuguese market could be further supported by changes in the way contract provisions are administered in the Portuguese courts. As discussed in Chapter 5, if compared with an English judge who usually comes to his or her position as an experienced lawyer, a Portuguese judge who come to the bench as a court clerk may well lack any experience of the market. This lack of market experience may make it more difficult for Portuguese judges to identify common commercial practices. To overcome this problem, it is proposed that Portuguese judges

\[6\] Ingrid M. Hillinger, 'The Article 2 Merchant Rules: Karl Llewellyn's attempt to achieve the Good, the True, the Beautiful in Common Law' (1985) 73 Géöorgetown Law Journal 1141
who hear commercial cases should also be appointed from the ranks of experienced commercial lawyers. To make it easier for the Vietnamese judges to find commercial practices in the market, it should be possible for them to refer to sources of law other than legislation (scholarly writing and social researches, for examples). In addition, decisions should be published so that the media, lawyers, scholars and other public members can criticize or comment on the consistency of the law with common practices in the market, thus creating a body of learning on market practice to which judges could refer.

Following this agenda for reform, what could be achieved for the Vietnamese market might be a contract law system that supports contractual arrangements in the market. Merchants disputing gaps in their contracts may then be able to ask the court to help them identify common practices in the market without incurring high transaction costs and facing the risk of their contractual arrangements not being recognized and enforced by the court. Opportunistic behavior in the market can then be reduced, as both the formal contract law system and the informal institutional structures of the market would better support similar commercial practices. Reduction in transaction costs and opportunistic behavior would encourage more exchange to be planned into the future and, consequently, more efficient use of resources in the market.
Figure 1

Setting norms *ex ante* and enforcing norms *ex post*

(Assumption: no opportunity cost)
<table>
<thead>
<tr>
<th>Norms</th>
<th>contract law = legal norms</th>
<th>‘merchant law’ = relational norms</th>
</tr>
</thead>
<tbody>
<tr>
<td>Enforcement mechanisms</td>
<td>The legal process</td>
<td>Market selection</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Long-term relationship</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Private power</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Business networks</td>
</tr>
<tr>
<td>Sanctions</td>
<td>Damages</td>
<td>Loss of relation-specific investment</td>
</tr>
<tr>
<td></td>
<td>Restitution</td>
<td>Loss of reputation (future deals)</td>
</tr>
<tr>
<td></td>
<td>Specific performance</td>
<td>Private sanctions</td>
</tr>
<tr>
<td></td>
<td>Court costs</td>
<td>Network sanctions</td>
</tr>
<tr>
<td>Transaction costs</td>
<td><em>Ex post</em> costs of legal drafting (usually after negotiation of business issues)</td>
<td><em>Ex ante</em> costs of learning the ‘rule of the game’</td>
</tr>
<tr>
<td></td>
<td><em>Ex post</em> costs of legal actions and the legal process</td>
<td><em>Ex ante</em> costs of building relationships</td>
</tr>
<tr>
<td></td>
<td></td>
<td><em>Ex ante</em> costs of procuring private power</td>
</tr>
<tr>
<td></td>
<td></td>
<td><em>Ex ante</em> costs of maintaining business networks</td>
</tr>
</tbody>
</table>
QG’s anticipatory profit = 2000
QG’s legal drafting cost = 500
QG’s court cost = 2000
QG’s ex ante investment = 1000
SD’s regret cost = 1000
Figure 4
<table>
<thead>
<tr>
<th></th>
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<th>leave</th>
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<td>0, 0</td>
</tr>
<tr>
<td></td>
<td>-1, 1</td>
<td>-1, 0</td>
</tr>
<tr>
<td></td>
<td>Jim</td>
<td></td>
</tr>
<tr>
<td>-------</td>
<td>---------</td>
<td></td>
</tr>
<tr>
<td>claim</td>
<td>-k, -k</td>
<td></td>
</tr>
<tr>
<td>leave</td>
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</tr>
<tr>
<td>claim</td>
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</tr>
<tr>
<td>leave</td>
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<td></td>
</tr>
<tr>
<td></td>
<td>Claim</td>
<td>Leave</td>
</tr>
<tr>
<td>-------</td>
<td>---------</td>
<td>---------</td>
</tr>
<tr>
<td>Claim</td>
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<tr>
<td>Leave</td>
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<td>-1, 0</td>
</tr>
<tr>
<td></td>
<td>Jack</td>
<td>Jim</td>
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</tr>
<tr>
<td>leave</td>
<td>-1, 1</td>
<td>-1, 0</td>
</tr>
</tbody>
</table>
# TABLE OF INTERVIEWS

<table>
<thead>
<tr>
<th>Interviewees</th>
<th>Date of interview</th>
<th>Place of business</th>
<th>Description of business</th>
</tr>
</thead>
<tbody>
<tr>
<td>Merchant # 3</td>
<td>10/12/2003</td>
<td>Ho Chi Minh City</td>
<td>Head of the legal department of a state-owned company that runs a major port in Ho Chi Minh City.</td>
</tr>
<tr>
<td>Merchant # 17</td>
<td>16/12/2003</td>
<td>Ho Chi Minh City</td>
<td>Director of a garment company, exporting to Europe and the United States.</td>
</tr>
<tr>
<td>Merchant # 30</td>
<td>20/11/2004</td>
<td>Vinh Long City</td>
<td>Member of the managing board of a tobacco company</td>
</tr>
<tr>
<td>Merchant # 31</td>
<td>21/11/2004</td>
<td>Vinh Long City</td>
<td>Manager of an industrial zone</td>
</tr>
<tr>
<td>Merchant # 32</td>
<td>23/11/2004</td>
<td>Vinh Long City</td>
<td>Director of a pharmacy company</td>
</tr>
</tbody>
</table>

**Group 1: Vietnamese merchants in the state sector**

**Group 2: Vietnamese merchants in the private sector**

<p>| Merchant # 1 | 05/12/2003 | Ho Chi Minh City | Director and main shareholder of two factories manufacturing construction materials (paints and clay powder for smoothing walls), with around twenty workers. |
| Merchant # 2 | 09/12/2003 | Ho Chi Minh City | Managing partner of an auditing firm of around fifteen employees. |</p>
<table>
<thead>
<tr>
<th>Merchant #</th>
<th>Date</th>
<th>City</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Merchant # 29</td>
<td>20/11/2004</td>
<td>Vinh Long City</td>
<td>Director of a construction consultant company</td>
</tr>
<tr>
<td>Merchant # 4</td>
<td>12/12/2003</td>
<td>Ho Chi Minh City</td>
<td>Managing director of a consulting company, active in trade, marketing, and foreign investment consultancy.</td>
</tr>
<tr>
<td>Merchant # 5</td>
<td>15/12/2003</td>
<td>Ho Chi Minh City</td>
<td>Director and main shareholder of a trading company in industrial machinery and equipments for mining industry.</td>
</tr>
<tr>
<td>Merchant # 18</td>
<td>17/12/2003</td>
<td>Ho Chi Minh City</td>
<td>Director and main shareholder of a furniture company with two factories, selling domestically and exporting wooden furniture to Europe.</td>
</tr>
<tr>
<td>Merchant # 19</td>
<td>18/12/2003</td>
<td>Ho Chi Minh City</td>
<td>Director of a family-owned resort complex in Ho Chi Minh City. The complex includes a medium-size hotel, with tennis courts, swimming pool, luxurious villas, a dock for tourist ships, and a restaurant.</td>
</tr>
<tr>
<td>Merchant # 21</td>
<td>20/12/2003</td>
<td>Ho Chi Minh City</td>
<td>Director of a construction company in Ha Noi, mainly worked as contractor for state-funded infrastructure projects in Northern Vietnam.</td>
</tr>
<tr>
<td>Merchant # 23</td>
<td>04/01/2004</td>
<td>Ho Chi Minh City</td>
<td>Managing lawyer of a large law firm, active in commercial law areas.</td>
</tr>
<tr>
<td>Merchant # 24</td>
<td>06/01/2004</td>
<td>Ho Chi Minh City</td>
<td>Director and a shareholder of a telecommunication company.</td>
</tr>
<tr>
<td>Merchant # 25</td>
<td>07/01/2004</td>
<td>Ho Chi Minh City</td>
<td>Director and owner of a logistic company</td>
</tr>
<tr>
<td>Merchant # 26</td>
<td>09/01/2004</td>
<td>Ho Chi Minh City</td>
<td>Director of a logistic company. The company is a venture in Vietnam of a Taiwanese group. The company's clients are mainly foreigners in Ho Chi Minh City.</td>
</tr>
<tr>
<td>Merchant # 27</td>
<td>10/01/2004</td>
<td>Ho Chi Minh City</td>
<td>A custom broker, working for a logistic company in Ho Chi Minh City</td>
</tr>
<tr>
<td>Merchant # 28</td>
<td>10/01/2004</td>
<td>Ho Chi Minh City</td>
<td>Director and owner of a company trading and manufacturing textile and</td>
</tr>
</tbody>
</table>
garment equipment in Ho Chi Minh City

**Group 3: Vietnamese merchants of Chinese ethnic (Hoa merchants)**

Merchant # 6  22/12/2003  Can Tho City  Chairman of a joint-venture in Can Tho, manufacturing steel bullet nails, mainly for export. He also runs his own family company trading in grains, fertilizers, and insecticides in Mekong Delta.

Merchant # 7  22/12/2003  Can Tho City  Major shareholder of a joint-venture of company, member of the board of director

Merchant # 8  23/12/2003  Can Tho City  Director of a family-owned factory manufacturing construction materials, and an outlet network in Can Tho and surrounding provinces.

Merchant # 9  23/12/2003  Can Tho City  Director of a family company trading in fertilizers and insecticides in Mekong Delta.

Merchant # 10  26/12/2003  Can Tho City  Director of a family company manufacturing kitchenware, with around one hundred and fifty workers.

Merchant # 22  26/12/2003  Ho Chi Minh City  Director of a family company trading auto spare parts

**Group 4: Vietnamese merchants in Phnom Penh (Cambodia)**

Merchant # 11  03/01/2004  Phnom Penh  Director of a family company trading Vietnamese products in Phnom Penh.
Merchant # 12  05/01/2004  Phnom Penh  Representative in Cambodia of an industrial company in Vietnam manufacturing electronic appliances. He runs a network of retail agents for the company's products in Phnom Penh.

Merchant # 13  06/01/2004  Phnom Penh  Representative in Cambodia of a food company in Vietnam, exporting various food products to Cambodia.

Merchant # 14  08/01/2004  Phnom Penh  Director of a company that runs a supermarket and some restaurants in Phnom Penh. The company is a subsidiary of a trading company in Vietnam.

Merchant # 15  11/01/2004  Phnom Penh  Director and owner of a company that runs a large IT supermarket in Phnom Penh.

Merchant # 16  15/01/2004  Phnom Penh  Director of a Cambodian logistic company, which is an affiliate of a Vietnamese logistic company in Ho Chi Minh City.

**Group 5: Merchants of Western background in Vietnam**

Merchant # 20  19/12/2003  Ho Chi Minh City  An European merchant, director of a company manufacturing wooden furniture in Ho Chi Minh City, exporting to Europe and the U.S.

Merchant # 33  19/7/2005  Melbourne  An Australian merchant, owner and director of several consultancy and property development in Vietnam, who has been working in Vietnam for more than a decade.
A retired Australian merchant who used to work as executive and manager of multinational companies in Vietnam for nearly a decade.
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