Non - State Business Sector Development and Job Creation

Contents

Foreword

In April 1999 the Government requested UNDP assistance in the preparation of strategic policy-based research for Viet Nam's new Ten Year Socio-Economic Development Strategy 2001-2010. A Technical Assistance project agreement with MPI was signed in September 1999.

The Project subsequently undertook and synthesized policy-based research aimed at offering international perspectives in four key areas central to the new ten year socio-economic development strategy:

- The Role of the State and the Market
- International Economic and Financial Integration
- Rural Economic and Social Development
- Science, Technology and Industrial Development

In addition, the Project offered advice on the long term socio-economic objectives to 2010 and provided practical principles and recommendations for the coherent implementation of the proposed strategies.

The Project also organized a series of technical workshops on the draft research papers as well as two high level Round Table Consultations between senior officials from the Government and the donor community. The first of these Round Tables was held in June 2000 and focused on the various draft research papers and related recommendations. The second high level Round Table was organized in November 2000 with a focus on the Government's draft of the new ten year socio-economic strategy.

MPI has been the national executing agency responsible to the Government and UNDP for the achievement of the Project's objectives, and DSI – the Development Strategy Institute - has carried implementation responsibility. Throughout, the research and consultation process was directed jointly by DSI and UNDP. In addition, the Governments of Australia and Sweden, as well as UNIDO contributed financing as well as technical support for the Project.

In the course of the project, twelve research reports and two Round Table Proceedings Reports were produced jointly by international and local experts.

The foreign experts who participated in the Project included Bob Warner, Keith Bezanson, James Riedel, Lars Holmstrom, Rebecca Dahele, Scott Fritzen, Garry Smith, Frank Flatters, Mia Huyn, David Dapice, Borje Lunggren, Suiwah Leung and Ari Kokko.

Local experts contributing to the Project's work included Dao Le Minh, Vu Van Toan, Vu Quang Minh, Nguyen Van Chi, Bui Tat Thang, Nguyen Van Phuc, Pham Dinh Lan, Le Viet Hoa, Tran Ngoc Ca, Tran Thi Thanh Hong, Bui Thien Son, Dang Kim Son, Bui Van, Phan Minh Ha, Nguyen The Hien, Nguyen Van Thanh, Nguyen Xuan Thu, Le Thi Kim Dung, Luu Duc Hai, Le Anh Son, Hoang Minh Hai, Ta Thi Thu, Nguyen Quang Thai and Pham Quang Ham.

The research and consultation process benefited greatly from the guidance and substantive advice provided by Dr. Luu Bich Ho, President of DSI/National Project Director, Nguyen Van Vinh, National Project Manager, Bui Bich Hoa, Assistant to Project Management Board as well as by officials from UNDP Viet Nam including Robert Glofcheski, Vu Quoc Huy, Johan Fredriksson, Eliane Darbellay, Ernst van Koesveld, Michael Zuyderduyn and Klaus Greifenstein.

A listing of the reports produced by this unique initiative is provided below:

- The Role of the State and the Market in the Economy of Viet Nam
- Non-State Business Sector Development and Job Creation
- Globalization and International Economic Integration
- International Financial Integration
- Further Perspectives on the Challenges of Integration
- Agriculture and Rural Development
- Rural Development and Off Farm Employment
- A Rural Social Development Strategy
- Science, Technology and Industry Strategy for Viet Nam
- Strategic New Generic Technologies
- Choices and Opportunities
- The Synthesized Report of the Research Project

The views expressed in this research report do not necessarily reflect the official views or policies of MPI or UNDP.

H.E Tran Xuan Gia	**Edouard A. Wattez**
Minister	Resident Representative
MPI	UNDP

1. Background

The purpose of this brief paper is to outline the main strategic and policy issues related to private sector development in Viet Nam and to offer recommendations as to how the private sector could contribute to the achievement of some of the key objectives in the new 10 year socio - economic development strategy for Viet Nam.

The paper is a summary of a report that has been prepared as part of the joint MPI-UNDP project to assist the Government in the preparation of the socio - economic development strategy up to 2010. The report builds on the work done on “the Role of the State and the Market” during the first phase of the project.

Due to the limitations imposed on resources and time available to do the study, the report does not purport to be a comprehensive treatment of the subject. The analysis and conclusions proposed are by intention synthetic – drawn extensively and freely from available work by Government agencies and donors.

2. Why Focus on Private Sector?

With the reforms in 1990 that allowed private ownership and activity, the private sector in Viet Nam has grown rapidly, primarily through the creation of small household and micro enterprises but also as a result of some incorporated private companies. From a small base in 1991, around 2,5 million household enterprises have been established and well over 40,000 companies have been registered. The private sector contribution to Viet Nam's economy is significant at about 50% of GDP and 91% of total employment.

In spite of these positive statistics, there are a number of problems in the private sector which prevent these enterprises from living up to their potential and contribute more fully to Viet Nam's long term objectives of growth, income, employment generation and poverty reduction.

Although several measures have been taken recently to address some of the constraints to private sector development, the private sector still remains much more constrained than in other countries in the region, including China. Private enterprises in Viet Nam still have less access to credit and land use rights and face more restrictions on private entry and access to information and services relative to other countries in East Asian. In addition, there is still an uneven playing field between private firms and state enterprises. The discrimination in favour of the state sector crowds out private companies as state enterprises absorb most of the resources available in the economy. This difficult business environment limits the private sector and reduces its competitiveness.

There are good reasons to believe that, if the climate for private business is improved, a more dynamic corporate private sector would mean:

- more investment
- more jobs
- and less poverty

In addition, private sector development is intimately coupled with the ongoing trade, banking and SOE reform process. It is not likely that these important reforms will be successful without a dynamic private sector and without private investment that is badly needed to exploit the opportunities provided by a more open trade regime and to create growth and employment when the state reforms the state enterprise sector.

If a stronger private sector will have these positive effects, then the issue of creating a better environment for private business should constitute one of the more important strategic priorities in the new 10 year socio - economic development strategy for Viet Nam.

Before reviewing the current status of the private sector more closely, we will discuss briefly the basis for the above statements on the positive effects of a better business climate for private enterprises.

More investment

Total investment as a share of GDP fell sharply from 29 per cent in 1997 to an estimated 19 per cent in 1999, due in large part to the fall in foreign investment (Table 1.1). Almost all investment components were lower in 1999 including both ODA-funded public investment, SOE investment, and household and domestic corporate investment.

Table 2.1 Investment share in GDP (per cent)

Share of GDP	***1997***	***1999***
		Est
Public investment	10.6	8.8
Government budget	6.6	5.7
Investment credit (incl. On-lending)	4.0	3.1
SOE investment	4.2	2.2
Non - State investment	6.4	5.5
FDI	8.3	2.2
Total investment	29.2	18.7

Source: World Bank, 2000.

The 1999 total investments as a share of GDP were the lowest since 1993. In 2000, total investment as a share of GDP has risen slightly although foreign investment remains depressed. The investment trend must be reversed as Viet Nam will not be able to attain its long term socio - economic objectives at current savings and investment rates.

The sharp decline in foreign investment inflows may be reversed in the medium term with improvements to the foreign investment regime, the development of natural gas resources and recently concluded the Viet Nam – US trade agreement, but foreign investment inflows are unlikely to reach the levels of the 1994-1997 period.

While foreign direct investment is indispensable for a country at Viet Nam's level of development, the main long - term source of growth and development will have to be domestic investments in both labour intensive activities as well as in new business areas created in the global economy. In the future, there needs to be much greater reliance on the domestic private sector for the investment required to meet the growth targets of the new ten year socio - economic development strategy. An investment scenario consistent with the macroeconomic framework prepared for the new strategy shows that the share of GDP devoted to non-state investment may need to double over the next decade. Attaining higher and sustainable rates of domestic savings will require several combined efforts including two major reforms of the Vietnamese economy – the development of a safe, sound and competitive banking system, and a more competitive enterprise sector including a better environment for private enterprise.

Substantially higher levels of private investment are required in both manufacturing, services and agriculture. In addition, private investment will be required in infrastructure. The Government faces a dilemma in terms of satisfying growing demands for infrastructure combined with serious constraints in public funding. Viet Nam will have to commit about USD 3 billion a year – or around 12 per cent of GDP – in the next years to meet the infrastructure needs of the nation. As Government budget funding of infrastructure investments is unlikely to exceed 3 per cent of GDP and ODA funding 2 per cent of GDP, there is a significant financing gap of 7 per cent – or USD 2 billion a year. Financing of this gap will need to be sought from private, mostly foreign, sources. Such financing will only be forthcoming if investors perceive that they will receive fair and equitable treatment under a pro-private sector environment that reduces the non-commercial risks of these capital intensive investments.

So far, Viet Nam has not benefited from private finance in infrastructure development. Apart from the obvious advantages Viet Nam would obtain in getting access to non public funding and expertise, it is important to remember that private finance in infrastructure will replace the need for public expenditure and indebtedness, thereby allowing the Government the choice of channeling scarce financial resources to the core public spending functions of Government in education, health and social services.

More efficient investment

Even if “more investment”, is important for Viet Nam, the quality of investment is perhaps even more important. In terms of infrastructure, Viet Nam must invest in the projects with the highest rate of return whether the investment is made by the public or the private sector. Examples of major Vietnamese infrastructure projects that did not take their rate of return into account are numerous. The keys to greater efficiency are stronger markets and stronger competition. Infrastructure projects around the world are notoriously subject to poor planning, resulting in cost over-runs and corruption unless a major effort is made to introduce real competition into the contract award process. In Viet Nam, real competition between public and private enterprises in bidding for infrastructure projects would ensure a more efficient use of scarce resources.

The efficiency and productivity argument also underpins the importance of an increased private sector share of industrial investments, and the consequent emphasis on the need to free up the private sector so that it can be allowed to grow alongside and in competition with the state sector.

Research in our project shows that private enterprises – primarily in manufacturing – are normally more successful than state enterprises in low wage, labour-abundant, open economics. By “more successful” what is meant is that, if treated fairly, private enterprises earn higher returns on investment than state enterprises or smaller household businesses. As a result they are better able to compete for scarce resources and emerge as the predominant form of business enterprise in most sectors of the economy, and in particular in fast developing areas of the global economy that require quick and flexible decision making. A major reason for the predominance of private companies in most of the East Asian countries is the fact that they are normally small enough to be flexible and large enough to be efficient and profitable. Our research shows that it is possible to create efficient SOEs if they are forced by competitive pressures to become as efficient as the other firms in their industry. But efficient SOEs are rare and require a clear purpose and a firm hand from the Government. More often, SOEs become effective interest groups and prevent competition, always arguing for more time to become competitive and requiring subsidies or high monopoly prices. In that case, their deficits or monopoly prices make the nation poorer.

A more competitive and fair business environment and more private investment in Viet Nam should therefore result in a higher overall rate of productivity and efficiency in the Vietnamese economy.

More jobs

One of the biggest challenges for Viet Nam in the next decade will be to generate productive jobs for the 1.2 – 1.4 million people entering the labour market each year, and at the same time reduce the levels of underemployment in rural areas and unemployment in some urban areas of the country.

The private sector employs about 90 per cent if the workforce, the state sector about 9 per cent and the foreign invested sector less than 1 per cent. The dominating private sector category is households and farms while the employment base among domestic formal private enterprises is very small and even less in the foreign invested sector. Employment growth has been significant in the domestic private corporate sector in recent years, although the number of employees is still only about 0.5 million. The corresponding number for SOEs is about 2 million, for Government administration around 1.4 million, for foreign invested firms about 0.25 million and for households and farms about 34 million.

A major reason why the non-farm private sector is so important from a socio - economic point of view is that this sector is where the employment generation potential is the greatest. Promotion of SMEs is also the most cost-effective prospect for generating new jobs as the average capital cost to create a job in SOEs was between 4 and 26 times higher than in different forms of formal private enterprises, according to a survey conducted in 1999. The state sector employs less than 10 per cent of the labour force and accounted for over 85 per cent of the total registered capital in all new enterprises between 1991 and 1997, illustrating the high capital intensity of SOEs as well as their limited ability to create employment. Evidence from other countries also confirm that small and medium companies are more efficient users of capital under most conditions.

Research in our project has concluded that SOEs in Viet Nam will not be able to make any net contribution to total employment in the medium term as several state enterprises will have to be equitized, divested or liquidated and the remaining firms restructured and in several cases down-sized to enhance efficiency and competitiveness as Viet Nam opens up to the international economy.

Government administration which employs an estimated 3.5 per cent of total workforce is not expected to create jobs either, with public administration reform in the coming years aimed at increasing efficiency, based on an unchanged or reduced number of employees.

The share of agriculture in total employment is still very high – about 70 per cent. In the medium to long term, the only way to raise agricultural income will be to increase productivity and diversification and this will result in the farm sector progressively shedding workers into a growing rural and urban non-farm sector. As one of the goals in the draft 10 year socio - economic development strategy is to reduce agricultural employment to 50 per cent in 2010, we should not expect agriculture to make a net contribution to total employment in the next decade.

If our analysis is correct so far that the state sector and agriculture are not expected to contribute to total employment growth in the next 10 years – the net contribution will probably be negative – where can we expect the bulk of the new jobs to be created? The answer is: the informal and formal private sector economy.

The Vietnamese household enterprise sector has grown rapidly from about 800,000 in 1990 to around 2.5 million enterprises in 1999. The sector is estimated to provide incomes for roughly 20 per cent of the labour force and its contribution to GDP is not insignificant although productivity is assumed to be low. The great majority of these very small enterprises are engaged in retail trade, but there is also a substantial proportion of household enterprises involved in small scale microenterprise-based manufacturing. Employment in household activities has grown steadily by over 5 per cent per year with a higher rate in rural than in urban areas, and 0.4 to 0.5 million new jobs have been generated each year.

Is it realistic to expect this sector to continue growing at this rate or higher in the medium to long term? The sector will no doubt be able to continue to generate a large number of jobs also in the future. The problem is that if the non-farm informal sector absorbs a large share of the workforce growth and of underemployed and unemployed people, the sector would not be able to offer productive jobs that could take advantage of existing skills and build new ones. Productivity in this sector is already low and the work is generally poorly paid and insecure.

The foreign invested sector has been the star performer in output growth over the past 5 years. These firms are currently estimated to account for about 10 per cent of GDP and more than 30 per cent of manufacturing output and have managed to maintain growth rates of 15-20 per cent a year since 1995. However, the sector employs less than 1 per cent of the labour force and the annual job growth has been less than 20,000 in the 1994-98 period when foreign direct investment inflows averaged USD 2 billion a year. The main reason for the small employment base in this sector is the high capital intensity of FDI in Viet Nam, motivated primarily by the country's import substituting trade policies. Even if an improved business environment, trade regime and new trade agreements should increase current low FDI inflows over time, the sector will probably play a relatively modest role in adding new jobs in the medium term, at least directly.

The domestic corporate private sector has accounted for roughly 7 per cent of GDP in the past 4 years and its output growth rate has actually dropped every year during this period. The sector has, however, registered an outstanding performance in job creation with double-digit growth rates in the last 3-year period. Still, the absolute number of employees in this sector remains small at about 0.5 million and growing by about 70,000 a year.

What is the potential for significant, sustainable growth in output and jobs in the formal private sector in the years to come? We have to remember that this sector still comprises a relatively small group of firms, producing low margin products and services concentrated primarily in trading and in certain manufacturing sectors such as food and beverage production, wood processing, garments and textiles. In order for this sector to play as significant a role in growth, exports and job creation as private companies have elsewhere in the region, major changes in the business environment and in investor confidence would be required. Many private firms would have the capacity to grow given the appropriate incentives and resources, but many more people would have to start new businesses or develop their household and micro enterprises into larger, more formal SMEs. This will only happen with the improvements in the business climate that are suggested in the next chapter of this report.

One indication of the potential of the private sector in Viet Nam is the effect of recent reform measures. The implementation of the new Enterprise Law and the removal of more than a hundred business licences have generated a positive response from the private sector with 10,000 private firms registering from January to October 2000. Additional research into the characteristics of the new enterprises will give indications of the effect on net job generation and whether such exceptional growth of private enterprises could be sustained.

Less poverty

Viet Nam has experienced a decade of remarkable progress in reducing poverty and providing improved livelihoods for its people. During the 1992-1999 period, real per capital income (in VND) increased by an average 5.8 per cent a year (IMF 2000), and the share of people living below the poverty line fell from 58 per cent in 1992/93 to 37 per cent in 1997/98. The level of food poverty defined as persons with expenditure lower than the cost needed to obtain daily food equivalent of 2,100 kcal, also declined significantly over this period, from 25 to 15 per cent.

The Attacking Poverty report (World Bank et al 1999) attributes the decline in poverty to high growth rates and to agricultural diversification. In rural areas, where 75 per cent of the poor live, living standards benefited primarily from more diversified and rising agricultural incomes but also from a healthy growth in household non-farm employment opportunities. The report concludes, however, that the gains in poverty reduction remain fragile, and that the slowing of economic activity over the past few years may have pushed a number of poor people back below the poverty line.

The report concludes that the past relationship between the level of growth and the impact on poverty might not hold in the future, as Viet Nam may not be able to replicate the land reform-based, agricultural diversification success story from the early and mid-1990s. The sources of growth are likely to be different in the next 5-10 years. The main challenge will be the creation of rural non-farm employment as well as urban employment. A broad range of structural reforms will be required to this end, and in particular more favourable conditions for small and medium scale new enterprises. Such actions would also contribute to more equitable distribution of the benefits of growth, as domestic private investment is more likely to be labour intensive and to include a greater share of investment in rural areas. For these reasons, the further development of the private sector will be of crucial importance in attaining the Government's poverty reduction objectives stated in the draft socio - economic development strategy up to 2010.

Private sector and other reforms

A fourth major reason for further developing the private sector is the inter-relationship and interdependence between the private sector and other major reforms areas.

It is argued that private sector development is intimately coupled with reforms of trade policies, SOEs, and the financial sector and that these important reform programmes are not likely to be successful without a dynamic private sector and without private investment that is needed to exploit the opportunities provided by a more open trade regime and to create growth and employment when the government reforms the state enterprise sector.

Even if Viet Nam's trade system still remains more restrictive than that of its neighbours', trade policy is the reform area where progress has been most satisfactory in recent years. In addition to the long-term commitment to trade liberalization under AFTA, the Government has taken several steps to reduce restrictions on foreign trade, applied for WTO membership and – most recently – signed a comprehensive bilateral trade agreement with the United States. The overall promise of these integration efforts for Viet Nam is that better resource allocation, easier imports of technology, goods and services, and expanded market access will together translate into increased economic growth. These benefits, however, are potential benefits that will only be realized if other complementary policies and institutions are put in place. One of most important of these is to create an investment environment that is attractive for both local and foreign investors that will enable a large number of entrepreneurs in the private sector to take advantage of the benefits from integration. Without an attractive investment climate and a dynamic private sector there is a risk that integration will not yield much for Viet Nam.

Another major reason to focus more on the private sector is that the ongoing reform of the state enterprise sector is not likely to be successful without a dynamic private sector. One reason is related to competition. A restructured, more efficient SOE sector is not likely to emerge if a strong and competitive private sector is not established alongside state enterprises. There is a risk that a weak private sector would set the standard for SOEs and result in sub-optimal performance. Another reason is related to the consequences of SOE reform. Much more private investment will be needed to create growth and employment to compensate for the impact of proposed SOE reforms that will result in the liquidation of non-viable state enterprises, and the restructuring and downsizing of surviving SOEs.

3. Current Status

The private sector in Viet Nam consists of farmers, very small household enterprises, private enterprises and foreign invested companies. Data on the private sector is limited and difficult to verify. However, the following characteristics are worth observing.

First, the share of the private sector in total GDP is 51 per cent (Table 2.1), which is roughly the same as in 1993. The contribution of the domestic private sector to GDP has grown more slowly than that of the public sector in the past 4 years, while the foreign invested sector – with a 10 per cent share of GDP – has been the star performer with growth rates in its contribution to GDP of 13-20 per cent per year throughout the period, and with a successively larger share of GDP than the formal domestic private sector since 1996.

Table 3.1 Composition and growth in GDP by enterprise form, 1996-1999

	1996		*1997*		*1998*		*1999*	
	Share (%)	*Growth (%)*	*Share (%)*	*Growth (%)*	*Share (%)*	*Growth (%)*	*Share (%)*	*Growth (%)*
Total GDP (in billions of VND) & growth rate	**213,833**	**9.30**	**231,264**	**8.20**	**244,596**	**5.80%**	**256,269**	**4.80**
Public	**50.00**	**9.80**	**50.10**	**8.40**	**49.70**	**5.20**	**49.40**	**4.20**
- State sector	40.80	11.30	41.40	9.70	41.30	5.60	41.00	4.30
- Collective sector	9.20	3.60	8.70	2.64	8.40	3.50	8.40	3.60
Private	**42.70**	**7.20**	**41.70**	**5.70**	**41.10**	**3.80**	**40.50**	**3.60**
- Household & farmers	35.03	6.60	34.20	5.60	33.60	3.40	33.20	3.90
- Formal private sector	7.67	18.70	7.5	9.70	7.50	9.84	7.30	0.71
Foreign invested sector	**7.40**	**19.40**	**8.20**	**20.80**	**9.20**	**19.10**	**10.20**	**13.40**
Total	**100**		**100**		**100**		**100**	

Source: GSO (1999); GDP based on 1994 prices.

Second, the domestic private sector is by far the most labour intensive with a 90 per cent share of the labour force in 1999 compared with 9 per cent in the public sector and less than 1 per cent in the foreign invested sector (Table 2.2). Vietnamese private companies have demonstrated a strong ability to create employment. But even though domestic private companies have registered double-digit employment growth rates for the past four years, the bulk of the private labour force still consists of farmers and small households, and the employment base among domestic private companies is very small with a 1.4 per cent share of total employment in 1999.

Table 3.2 Composition and growth of labour by enterprise form, 1996 - 1999

	1996		*1997*		*1998*		*1999*	
	Share (%)	*Growth (%)*	*Share (%)*	*Growth (%)*	*Share (%)*	*Growth (%)*	*Share (%)*	*Growth (%)*
Total labour force & growth rate	**35,791,900**	**3.50**	**36,994,200**	**3.40**	**38,094,200**	**3.00**	**39,402,150**	**3.43**
Public	**9.10**	**-2.6**	**9.20**	**4.60**	**9.10**	**1.85**	**9.00**	**2.2**
State enterprises	5.10	3.70	5.20	3.80	5.20	2.97	5.1	1.4
State administration	3.60	-11.6	3.70	4.60	3.60	0.2	3.7	6.3
Collective sector	0.30	20.10	0.40	16.90	0.30	0.77	0.2	6.89
Private	**90.30**	**3.70**	**90.20**	**3.20**	**90.20**	**2.97**	**90.40**	**3.66**
Households and farmers	89.20	3.60	89.00	3.10	88.90	2.85	89.00	3.5
Formal private sector	1.10	13.70	1.20	12.00	1.30	11.55	1.40	11.38
Foreign-unvested sector	**0.60**	**132.90**	**0.60**	**3.90**	**0.70**	**8.32**	**0.6**	**8.86**
Total	**100**		**100**		**100**		**100**	

Source: GSO (1999).

Third, the household enterprise sector has grown rapidly over the past decade. The number of non-farm household enterprises has increased from about 800,000 in 1990 to an estimated 2,5 million in 1999. Including the owner, these small enterprises employ on average 3.3 people in rural areas and 6.3 in urban areas. The majority of household enterprises are engaged in the service sector with retail sales as the major activity. But about one fourth are involved in manufacturing, primarily food processing, textiles and garments and wood processing, and nearly 600,000 small household enterprises are estimated to account for as much as 14 per cent of total industrial production.

One of the problems with many enterprises in this group, however, is the fact that they remain in the household category and are failing to fully exploit their growth potential. The incentives for these firms to register are limited because of the more complex procedures and the stricter government control of formal private enterprises. The obligations of a household enterprise are less onerous than for registered firms even if their rights to do business are also more limited. The fact that the growth potential of this important part of the domestic private sector is constrained is a significant problem and one that has to be solved if the private sector is to develop further and contribute more fully to the country's long term development objectives of growth, income and employment.

Fourth, the formal private sector, which consists of private (or individual) enterprises, limited liability companies and joint stock companies has grown from a very small base in 1991 to roughly 40,000 companies by end-1999 (Table 2.3). In the first 6 months of this year about 7,000 private companies registered – and by the end of October more than 10,000 new enterprises had registered – no doubt a response to the implementation of the new Enterprise Law. The 2000 growth rate to date is exceptional relative to earlier years, and further research will determine whether this rapid growth of private enterprises will continue.

Table 3.3 Number of private companies by legal status, 1996 - 2000

	1996	*1997*	*1998*	*1999*	*First 6 months of 2000*
Non-State companies	**31,143**	**33,713**	**36,753**	**39,915**	**46,523**
Year-on-year growth (%)		**8.3**	**8.9**	**8.6**	**16.6**
"Private enterprises"	21,905	23,009	24,998	26,989	30,077
Year-on-year growth (%)		5	8.6	7.9	11.5
Limited liability companies	9,316	10,420	11,384	12,473	15,701
Year-on-year growth (%)		11.8	9.2	9.5	25.9
Joint stock companies	276	302	371	453	745
Year-on-year growth (%)		9.4	22.8	22.1	64.5

Sources: (1996 – 1999, GSO), (1999 – 2000, MPI).

Fifth, the state sector still dominates industrial production in Viet Nam with a 43.5 per cent of share of total output in 1999, which is about double the share of the domestic private sector (Table 2.4). But both the state sector and the domestic private sector share of industrial production have fallen since 1995 as the foreign invested sector share has been growing very fast to almost 35 per cent in 1999. A large share of foreign investment in industry is in the production of import substituting goods in capital intensive sectors, which in turn is a reflection of the incentives offered to foreign investors in the form of protection to these sectors.

Table 3.4 Industrial production by sector of ownership 1996 - 1999
(in per cent of total industrial production)

	1996	*1997*	*1998*	*1999*
Public	**49.9**	**48.6**	**46.5**	**44.0**
State sector	49.3	48.0	45.9	43.5
Collective	0.6	0.6	0.6	0.5
Private	**23.4**	**22.5**	**21.5**	**21.3**
Households	16.1	14.7	13.8	13.8
Private	2.4	2.4	2.2	2.0
Mixed	5.0	5.5	5.5	5.5
Foreign - invested sector	**26.7**	**28.9**	**32.0**	**34.7**

Source: GSO and IMF (2000).

Most of the formal domestic private sector companies operate in labour intensive sectors like garments, footwear, plastic products and seafood. On average, these firms export about three quarters of their production implying a greater export orientation than both SOEs and foreign invested companies. The Vietnamese private manufacturers have been characterized as a small and vulnerable group: small in terms of number of enterprises, average size, and share of GDP and total employment – and vulnerable because most are producing low-entry barrier, low margin products in export industries that are among the most “rootless” in the world, that is garments and footwear (MPDF 1999).

One remarkable characteristic of the manufacturing sector is that by 1998 less than 500 private firms had managed to grow to a size exceeding 100 employees. It is also remarkable that the total contribution of the modern private sector firms – limited liability and joint stock companies – is so small in spite of their gradual expansion in the past decade. Their share in manufacturing production is only around 5 per cent which corresponds to about 2 per cent of Viet Nam’s aggregate GDP. This is well below the potential of the private sector.

What are the main reasons for the comparatively small share of formal private enterprises in Viet Nam’s economy, and why have so few private companies managed to reach any size? The answer is partly down to a factor of time, as it is only in the past decade that private enterprise has been permitted at all. But another, more serious, factor is the continuing macro and micro disincentives to private investors. The next section calls attention to some of the major constraints to further private sector development in Viet Nam.

4. Constraints

From the above brief review of the private sector it is apparent that Viet Nam has not yet been able to create an environment that is conducive for private enterprise to grow and to fulfill its essential role on the economy. Providing such an environment and releasing the productive potential of private companies should therefore be a major objective in the new socio - economic development strategy for the next decade. Without addressing a number of remaining problems and constraints confronted by the private sector, private domestic and foreign investment is not likely to increase sufficiently to help achieve some of the principal economic and social targets stipulated for the period up to 2010.

It should be acknowledged that the private sector faces a better policy environment today than it did only 2 years ago. Regular dialogue between the Government and the private sector has helped create a better understanding of the current situation. The Government has developed a progressive private sector action programme under the Miyazawa Initiative. The programme includes actions that, if effectively implemented, will further ease private entry and level the playing field as well as create credit facilities and promotion agencies to support the private sector.

In addition, the new Enterprise Law, effective from January 2000, provides a strong basis for facilitating private entry. The law simplifies the registration process and provides more flexibility to entrepreneurs as regards capital requirements and number of shareholders. The response to the law has been very strong as more than 10,000 private enterprises have registered in the first 10 months of this year – a growth rate that is exceptional relative to earlier years. A number of measures have also been taken to improve the foreign investment environment, including a number of amendments to the Foreign Investment Law, effective from July 2000.

There is, therefore, no doubt that there has been progress in addressing some of the impediments that the private sector faces although real implementation of improved policies is only beginning and many constraints remain.

What are then the remaining barriers to further private sector growth and development in Viet Nam?

Credit

The share of bank credit to the private sector has increased in recent years to account for around half of the total, although most of this is agricultural lending. Only a few of the more successful private companies are able to get any credits from banks and other financial institutions, and even in these cases loans are small and of short maturity. Retained earnings, contributions from employees, friends and relatives, and loans from the informal sector are all much more important sources of credit than the formal banking sector. One major reason for the inadequate access of the private sector to formal credit is the overall shortage of credit, due to a low domestic savings rate in Viet Nam, and the small portion of savings deposited in the banking system. Another major reason is the fact that the bulk of available resources have been directed to SOEs. Private enterprises are also discriminated against by the rules in the banking system as private firms are normally required to present some collateral to obtain a loan, while SOEs are not, and as private companies pay higher rates of interest than SOEs. In spite of new regulations that reduce restrictive collateral requirements for private sector enterprises, in reality banks remain reluctant to lend to private companies. Continued government guarantees for SOE loans make these firms favoured borrowers, and the threats of penalties for bank officials making bad loan decisions make them conservative and risk averse.

Lack of access to credit has several negative implications for the private enterprises from not being able to start or expand their business, to relying on old technology and inadequate production facilities with consequences on product quality, productivity and competitiveness.

Clearly, finding solutions to the problem of financing private investment should be a top policy priority for the Government. Long - term solutions are related to government interest rate policies, measures to mobilize additional domestic and foreign savings, reform of the banking system, SOE reform, scrapping systems and practices that give preferential treatment to SOEs, and improving private sector access to other sources of financing including foreign investment and capital market resources.

Land

The ability of enterprises to be able to access, use and transfer land and to use it as collateral is one of the keys to facilitating private sector growth. Private enterprises have found it difficult to obtain land use certificates, and long - term land use rights – particularly in urban areas – have mainly been allocated to SOEs. The limited access to land use rights for private firms has in turn reduced private sector access to formal credit and restricted the ability to form joint-ventures with foreign investors. The lack of security of land use rights has also acted as a disincentive to private firms to expand their business. It also partly explains the relatively small number of private firms engaged in manufacturing, as this requires more significant investments over a longer term, which again requires a high rate of security of the use of land.

Reviewing existing regulations on non-agricultural land-use rights, reducing the cost of leasing land, and relaxing restrictions on land use to make more land available for industrial and commercial purposes would help to remove a major barrier that is currently limiting private sector start ups and expansion and help to ease private firms' access to capital.

Regulations and legal framework

One of the most frequently mentioned constraints to private enterprise growth in Viet Nam is the legal and regulatory environment. Although the new Enterprise Law has eased private entry significantly and helped to reduce many of the constraints that the private sector faces in entering into business or expanding operations, both domestic and foreign companies still feel that the climate for doing business in Viet Nam is very tough. The problems lie both in the volume and content of the laws and regulations but also and more often in the complexity, the lack of transparency, the frequent changes and the inconsistent interpretation and implementation of the legal framework. One of the consequences is high direct and indirect cost of operations. Another and more serious effect is a lack of predictability, which reduces investor confidence and deters investment and expansion.

The objective for the Government must be to create as favourable an environment as possible for both state and private businesses. In doing so, the emphasis of the legal framework should not be excessive control and regulation but providing support to the businesses by maximizing consistency in the incentive structure, increasing predictability and stability, ensuring consistent implementation of the legislation with the intent of the law, and enforcing equal treatment in practice by incorporating the concept of equal treatment in the law and monitoring implementation.

Market support institutions

Institutions to support the business community in Viet Nam are still not sufficiently well developed. The availability of business support services is limited, and the channels for Vietnamese entrepreneurs to access information are few. Good quality and reasonable cost business services such as accountancy, IT–and management consultancy services, market research, advertising and training remain limited. Most private Vietnamese enterprises perform these functions in-house, thereby raising their fixed costs and excluding the benefits of specialization. In addition, financial institutions and industry associations are often weak and in any case have little experience in supporting the private sector.

Access to good quality and up to date information is also severely limited, and domestic entrepreneurs have to operate with less information on products, markets and technologies than companies in other countries. Restrictions on Internet access and high costs of telecommunications and Internet use place severe limitations on access to information. Private firms are often at a disadvantage because SOEs normally enjoy preferential access to information through their joint venture partners and through government agencies and associations, and private enterprises have less access to trade fairs, exhibitions and trade and investment delegations – all important as sources of information as well as for finding business partners.

The limited access to information and weak market support institutions are a serious handicap for Vietnamese enterprises in general and for private companies in particular. Markets in more developed countries function in good part due to the presence of a number of market support institutions that keep the enterprises well informed, process market transactions and enforce the rules of the game. The Government has a special responsibility to facilitate access to relevant information and to open all possible communications channels for businesses. The Government also has the responsibility to support the development of appropriate institutions and to restructure existing institutions to meet the needs of the market place. In so doing, the Government will have to make information channels equally available to all enterprises and ensure that support institutions will render their services to both state and non - state companies.

Human resources

One of the major internal constraints to private sector growth is the problem in finding experienced and well-trained managers and skilled labour. Managers generally have no problems in running a small scale business, but they frequently lack the formal business knowledge and experience that is needed to manage a medium or large enterprise faced with international competition. Training opportunities are often expensive, and high quality practical and relevant business management training courses taught in Vietnamese are in short supply. Appropriate vocational training opportunities are also lacking.

Increased investment in developing skilled labour, widening the network of professional and occupational training centres and improving the quality of technical training and business management courses to suit the demands of the market will be needed. In addition, income tax rates for Vietnamese and foreign employees more comparable with other countries in the region, and more flexible labour market regulations are examples of reforms that should improve the availability of skilled management and labour in the country.

5. Conclusions and Agenda for Change

According to the draft Ten Year Socio-Economic Development Strategy for the period 2001-2010, Viet Nam will seek to catch up with its East Asian neighbours, double the per capita income, eradicate poverty, create a healthy and well-educated population, integrate into the world economy, and transform itself into a modern and industrial country. These are demanding goals. Meeting them will require both a high and sustained level of growth as well as an equitable pattern of growth.

The issue that this brief report is attempting to examine is what the implications of the above goals and challenges will be for the development of the private sector in the country.

In recent years, the Government has emphasized the importance of creating a climate conducive to private sector development, and several steps have been undertaken to support and strengthen private sector growth. But the implementation of these policies is only now beginning, and it is doubtful whether these changes will be important enough to allow for the private sector to contribute more significantly to the attainment of the goals expressed in the ten year strategy.

This report concludes that a more dynamic corporate private sector will have to be developed in order to meet the country’s long - term goals of more investment, more jobs and less poverty. Even though the private sector accounts for half of GDP, the bulk of this is accounted for by farms, households and foreign invested enterprises, while the domestic formal private enterprises account for only a small share of GDP – 7 per cent in 1999. The main reason for this limited development of registered private companies is that the private sector in Viet Nam still remains more constrained than in other countries, including China.

The report concludes that Viet Nam’s successful economic and social development over the next decade will depend to a large extent on whether the country will become a truly multi-sector economy in which both state and non-state enterprises are able to grow, and where the private companies are able to compete in an undistorted environment with the same freedoms as state enterprises.

The climate for entrepreneurs and for private sector business must therefore be further improved. There are four major policy issues that need to be addressed in an agenda for private sector development:

- Government commitment to further private sector growth
- Reforms in related policy areas
- Remaining barriers to private sector development
- Institutional support and capacity building

Government commitment to private sector

In creating a better environment for entrepreneurship and private business in Viet Nam, no measure is more important than the commitment of the Government to the role of the private sector in the country's economy. Even though the Prime Minister has emphasized the importance of a positive climate for private sector development and the Government has addressed several of the constraints that the private sector faces, there is still a continuing policy and administrative bias against the private sector and a lack of practical commitment to private sector development. A truly multi-sector economy based on equal opportunities has yet to emerge and the playing field is still very uneven with SOEs continuing to enjoy preferential access to virtually all resources in the country as well as continued protection from competition.

For future sustainable growth in the private sector, it is essential that this ambiguity is resolved. Without true political commitment to private sector development, and effective implementation of commitments and policies, growth will remain well below its potential, private investors' confidence in the economic system will remain weak, private entrepreneurs will continue to refrain from long - term investment and instead focus on trade and other areas where assets are easy to liquidate if policies change, and domestic savings will continue to remain outside the formal banking system. In short, a failure to strengthen and enforce its commitment to the private sector will mean that the Government will be forced to scale back its goals and targets for investment, employment, income generation and poverty reduction.

In resolving the "commitment" problem, a more coherent and consistent approach to the relative roles of the state and the market in the Vietnamese economy will have to be adopted. The remarkable social and economic achievements of the past 10 years were possible because the State expanded the scope and freedom of the market to operate. A further re-definition of the role of the state and the market will be needed to sustain rapid growth and socio - economic stability for the next decade and beyond.

In Viet Nam many leaders strongly argue for a leading role of the State sector, and this has also been emphasized in the latest draft of the new ten year socio - economic strategy. Analysis in our project has concluded that the term "leading role" is an important and valid concept if it means an efficient SOE sector, utilities and services that charge competitive prices for quality services, and a Government that creates the incentives and environment that allow all viable firms to learn, invest and prosper. But it is very likely that the indirect role of the State will be more important in promoting growth in the next 10 to 20 years. This does not rule out some direct role in terms of SOEs if competitive pressures are introduced and the SOEs are forced to become as efficient as the other – domestic and international – firms in their industry.

A consequence of an emphasis on a more indirect way of managing the economy would be to reconsider maintaining a dominant state share of the economy and to ensure equal treatment of state and non - state enterprises, and to realize a true multi-sector economy with equal opportunities for all enterprises regardless of ownership.

Reducing the direct government role in managing the economy will not automatically improve the environment for the private sector. A more pro-active role of the Government would be necessary to create the conditions to help domestic entrepreneurs to compete globally. The critical government frame would be to do everything in its power to help and support the private sector in building competitive advantage.

In addition, the Government would need to ensure that policy changes related to the private sector are effectively implemented at the local level. Currently, inconsistent interpretation and implementation of the legal framework and excessive bureaucratic interference by local officials are stifling the impact of important improvements to the investment environment introduced at the centre. A recent research paper* on the institutional differences between China and Viet Nam in the transition to a market-based economy claims that one major reason for the more successful industrial achievements outside of the big cities in China was the attitude by local governments vis-a-vis local enterprise. “In China the majority of local governments understood the requirements of local industry, nurtured local enterprise and clearly saw how nurturing these industries benefited the local community. Local governments in Viet Nam have seen their role toward local industry more as taxation and regulation, and if local industry managed to survive and grow, the local tax collectors descended on the firm and the local regulators suspiciously checked it for any number of violations. The result is that Viet Nam has very little local industry because it could not survive these predatory local governments”.

Redressing this problem will require training of local officials to end the bureaucratic approach to regulating private firms and encourage them to work instead to facilitate businesses and support the local private sector. Enforcement mechanisms will also need to be tightened to improve implementation and reduce discriminatory practices.

Reforms in related areas

Reforms focusing solely on the private sector will not be sufficient to generate the necessary growth. The reason is that the macroeconomic environment determines the success of any initiatives to promote private enterprise. Reforms focusing on SOEs, the trade regime, and the financial sector are therefore necessary to facilitate private sector development. Correspondingly, it can be argued that private sector reform is necessary for successful reforms of trade policy, SOEs and the banking sector.

Further trade reform will support the private sector by enhancing its access to imported inputs and to export outlets. But more importantly, by reducing import protection it promotes competition which is necessary to build competitiveness.

Further SOE reform and restructuring will also be required as there is otherwise a risk that the problems in the SOE sector may undermine any advances that are made in

* Institutional Challenges for the Economic Transition in Asia, D. Perkins, 2000.

terms of trade policy and promotion of the private sector. Continued SOE reform together with further restraint on bank credit to SOEs should also reduce “crowding-out” of credit to the private sector.

Bank restructuring and reform will help to reduce non-performing loans, improve liquidity, lower the share of policy lending, and re-orient bank management to view all loans on their commercial merit, including loans to the private sector.

Barriers to private sector development

The third major item on the agenda is the concrete policy reforms needed to eliminate all the major constraints to private sector growth highlighted in previous sections of this report. Even though measures have been taken recently to address some of these constraints, the private sector continues to face more restrictions on entry, has poorer access to credit, experiences greater difficulties in obtaining and using land use rights, and has less access to relevant business information relative to other countries in the region. These barriers reduce competitiveness, depress growth and make the nation poorer.

Recommendations on reforms to eliminate or reduce the impact of these disincentives have been proposed in section 3 of this report.

Institutional support and capacity building

On the institutional side, mechanisms to ensure contract enforcement, improved access to information, formation of private Vietnamese business associations and better availability of business services are among the requirements for better performance of private enterprises. Supporting institutions are currently providing insufficient support to the operation of the market, and information from outside Viet Nam on markets, trends and technologies is still difficult to access. The high cost of and the restricted access to the Internet limits access to valuable information, and key business services like accountancy, management consulting and market research remain underdeveloped.

The further development of these important support institutions will have to be encouraged to ensure that the gap in competitiveness between Vietnamese enterprises and companies in the region starts to close. It should be noted that these proposals only make up the first step toward a more efficient business environment. In the long run, reforms will also be needed in several other areas. The education system needs to adjust to the requirements of a more modern economy. Modern business training and demand-oriented vocational training programmes will be required as the private sector moves into industrial and service production with higher skill requirements. Reforms in the labour market will also be needed to create stronger links between productivity and wages.