Rural development and off farm employment

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.

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1. Background

Since 1995 the labour force in Viet Nam has been growing by more than 1 million people each year, and this will increase to 1.2 million or more each year in the next decade. Where will these people find decent jobs? Agriculture had been absorbing more than 600,000 a year, but these gains appear to be declining. Output per agricultural worker is only one-third of the national average, and falling relative to other sectors. Industry and construction jobs grew almost not at all since 1995, absorbing less than 2% of labour force growth. Services had been growing strongly, reflecting past deficiencies in those sectors, but recent gains have been only 200,000 per year rather than over 500,000 a year registered for 1995-97. All this suggests a looming crisis in employment. With more new workers than ever, and higher educational levels, it is unlikely that many will choose poorly paid farming over some kind of non-farm job. Unless there is a drastic change in the levels and type of industrial investment, the larger firms in that sector will be hard put to take more than 10% of the increased labour force. Service sector job growth is slowing. No plausible combination of government programmes and job growth along past lines will provide more than a fraction of the jobs needed. Yet without such job creation, there is a prospect of social evils, excessive urbanization, rising inequality, and instability.

The plan of this paper is first to show just how large the need for additional jobs is given even optimistic assumptions about various sectors. Second, it will discuss different types of rural non-farm and informal urban development, and review the known causes for slow growth of small and medium enterprises in Viet Nam, along with some suggestions for ways to reduce barriers and accelerate progress. These will be partly based on fieldwork undertaken for this paper, in which successful private firms from all over Viet Nam were interviewed. A summary will conclude with suggestions for next steps.

2. The Size of the Problem

One of the better sources on labour force structure in the 1990's has been the two living standards surveys. Covering thousands of households, they have provided rigorous and careful coverage of all regions in Viet Nam. They show a *low rate of structural change in the labour force.* This is true even though *output* growth was rapid and showed distinct structural change, as the share of agriculture declined and the share of industry rose, with little change in services. These changes are summarized in Table 1.1 on the next page.

In spite of the slow growth of farm jobs, in absolute terms farming still took on the largest amount of labour, absorbing nearly half of the growth in the labour force. Put another way, a 2.5% growth in farm output led to 1% growth in farm jobs. Services were the next largest absorber, taking a third of the new workers. It took only 1.7% growth in service output to generate a 1% growth in service jobs. Industry absorbed less than a fifth of workers, and it took more than 3% growth in industrial output to create 1% growth in industrial jobs. It would not be surprising for agriculture to have difficulty generating new jobs. It is unlikely to grow much more than 4% a year, while the return to labour in farming is far lower than in other sectors, and that gap is getting bigger. Normally, workers leave low paid jobs and move to better-paid, and easier, occupations. It is much more surprising that industry did so little to create new jobs. It has a high growth rate and also has high earnings per worker. Yet its share of the labour force changed little, while its output share surged to a third of total output.

Table 2.1 Changes in workforce and output structure in Viet Nam, 1993 & 1998

	Share of output		***Share of labour***		***Output growth***	***Labour growth***
	1993	***1998***	***1993***	***1998***	***1993-1998***	***1993-1998***
Agriculture (%)	28.9	23.5	71.7	69.0	4.2	1.7
Industry (%)	25.3	33.5	11.3	12.1	12.7	4.1
Services (%)	43.4	42.5	17.0	18.9	8.2	4.8

Notes: Agriculture refers to farming forestry and fisheries. Industry refers to manufacturing, mining, utilities, and construction. Services are all others. Growth rates are annual.

Industry has been dominated by state enterprises, and these have historically been overstaffed. They were able to increase output with little or no change in employment. In addition, many of the foreign enterprises were import substituting and capital-intensive. They allowed domestic production of cement or sugar or steel, but required very high investment per worker. Oil output, an important part of industry, was also like this. All FDI workers in 1998 were less than 10% of industrial workers, but they accounted for 30% of output. Finally, industry did not absorb more because of the marked weakness of the formal domestic private sector. It started from a small base and its share of total output fell. Most manufacturing jobs (more than two-thirds) came from the household sector. They accounted for 2.4 million manufacturing jobs, while state enterprises had 0.7 million; FDI firms about 0.2 million, and formal private firms only 0.1 million. Even if the *entire* formal sector in manufacturing could somehow *double* its workforce in five years, it would add less than one year's growth in the labour force!

One major question must be how many workers are likely to find jobs in agriculture. This sector still accounts for nearly seven out of ten workers, and was adding over 600,000 workers a year in the mid-1990's. However, there are several reasons to believe that future additions will be much lower. First, the physical output growth in agriculture is apt to be less, though value may rise faster. With many markets glutted (rice, robusta coffee, rubber), farmers are likely to focus on growing higher quality products rather than simply continue to push up quantity. Adding value may not use up so much labour as have past gains in increasing output. Second, as suggested earlier, the returns to labour are very low compared to other sectors. This normally leads to fewer entrants, if new workers have other options. Third, many of the new workforce entrants have more than a primary education, and are qualified for non-farm jobs. Comparative experience suggests they will opt for urban or at least non-farm jobs. For all of these reasons, I assume that agriculture will add only 250,000 jobs a year, or about 1% annual growth. This is half as much as estimated recent additions. It would leave one million new jobs a year to be generated by other sectors.

In the 1997-1998 Living Standards Survey, *wage earners accounted for only 11% of all workers.* Of all wage earners, about 22% were government, party, or military workers; 14% were in state enterprises, and 8% were in joint ventures or foreign firms. Over 41% were household or private enterprise workers, while 14% were "other", which is probably a form of private activity. Cooperatives and mixed were under 1%. From the survey, it appears that over half of all wage jobs probably come from domestic private activity. If the nearly 75% of mainly non-wage workers who engage in farming (and sometimes other activities) are removed, then "pure" non-farm jobs are just over a quarter of total jobs, with private domestic firms or households taking 70% of that total.

The outlook for employment gains in state enterprises is not strong. From 1995 to 1999, SOE jobs rose from 2.1 to 2.3 million in all economic sectors, including industry, agriculture, and commercial services. Given the pressure to shed or merge loss-making enterprises, and make the remaining ones profitable, it is not clear if even that modest growth will be repeated in the next five years. If it were, then state enterprises would absorb 3% of the new entrants to the workforce. At best, they will be a minor factor. At worst, they may actually shed jobs on a net basis.

The FDI sector in industry and services combined added 300,000 workers from 1993 to 1998. During this period, FDI inflows averaged about USD 2 billion a year. Recently, both commitments and actual inflows have been lower, though projections are for inflows to return to an annual USD 2 billion level. It is possible that these projected inflow levels will be reached and that the investment per worker will also fall from over

USD 30,000 per worker to only USD 20,000 per worker. This would happen if more of the projects were export oriented and fewer for capital intensive activities. If all went well, then the FDI sector would add 100,000 jobs a year, or 8-9% of the projected increase in the labour force. However, there are many risks on the downside and limited possibility that reality will surpass this optimistic projection.

The formal domestic private sector accounted for 11% of wage earners in 1998, or nearly 450,000 workers, up from 182,000 in 1993. It is certainly possible that this sector could “take off” and play a leading role in providing jobs. If it were to double its workers in five years that would imply an output growth of 20% a year, since output per worker would also be increasing. This would be very rapid growth, but is just barely within reach. If this ambitious goal were realized, another 7-8% of annual labour force growth would be absorbed by this small, historically weak, but potentially fast-growing sector.

Taking all these sources together, there are at most a half million workers likely to find jobs in agriculture or formal sectors of the state, FDI, or formal domestic private ownership. This leaves over 700,000 jobs each year to be created for new labour force entrants, and more for those who are now unemployed or underemployed. The rural non-farm and urban informal sectors are the likely destination of these residual workers. Mainly rural, these small and household level enterprises account for 10-11 million workers. Employment in these enterprises would have to grow 7% a year to absorb the workers. This is probably just possible if overall growth is high, in the 8-10% range, and if policies towards this sector are supportive. It is sobering, however, to think that even if other sectors outside of agriculture do *very* well in terms of creating jobs, still the largest burden will fall on these small, simple, undercapitalized, and low-skill enterprises.

It is important to note just how modest most of these informal firms are. Nearly 90% of self-employed firms have no employees, while the average rural enterprise has only 3 or 4 employees and the average urban informal enterprise has six or seven. Moreover, private firms tend to be distributed unevenly across regions. If a region starts from a low base, it will take faster growth to achieve an equal job gain compared to another region.

According to the living standards surveys, only one-quarter of workers nationally said they did not engage in farming at all, while three-quarters did at least some of the time. However, this ratio was as high as 96% in the Central Highlands, but as low as 35% in the greater HCMC region. These differences, shown in the table below, add another dimension to the answers of where new jobs might come from. The table’s last row also shows the level of earned income per capita per year in VND millions.

Table 2.2 Type of work and earned income by region in 1997/98

Work Type	***N. Mt.***	***RRD***	***NCC***	***SCC***	***CHL***	***HCMC+***	***MKD***
Ag. se (%)	67.9	46.1	53.4	42.9	65.6	19.1	40.0
Ag se + wage (%)	9.8	13.8	13.7	17.3	22.6	9.6	19.8
Ag+nonAg se (%)	11.7	18.8	18.7	8.3	7.6	6.1	10.3
Subtotal (%)	**89.4**	**78.7**	**85.8**	**68.5**	**95.8**	**34.8**	**70.1**
Wage (%)	3.6	8.8	4.8	13.9	0.5	34.6	11.9
Non-Ag se (%)	5.4	10.1	5.5	15.8	2.7	26.5	13.9
Non-Ag se + wage (%)	0.3	0.6	1.0	1.0	0.4	3.1	2.5
All three (%)	1.3	1.8	3.0	0.8	0.6	1.0	1.7
Subtotal (%)	**10.6**	**21.3**	**14.3**	**31.5**	**4.2**	**65.2**	**30.0**
Earned Income	*2.3*	*3.4*	*2.4*	*2.8*	*2.9*	*7.5*	*3.1*

Notes: Agriculture Self-employed is abbreviated "Ag. se". The regions are represented by abbreviations, with N. Mt. being the Northern Mountains and Highlands; RRD being the Red River Delta; NCC being the North Central Coast; SCC being the South Central Coast; CHL being the Central Highlands; HCMC + being the provinces around and including Ho Chi Minh City; and MKD being the Mekong Delta. In 1997/98 USD1 = about VND 13,500, or USD 200 = VND 2.7 million.

It is clear from this table that the region around and including HCMC is in a category by itself, with its share of non-agricultural jobs twice the next highest region, and an income per capita level two to three times the other regions. It is more surprising that the Mekong Delta with no major city has relatively more non-farm jobs than the Red River Delta, which includes Ha Noi and Hai Phong. This is even true for the South Central Coast! All three of these southern regions start with the advantage of needing less non-farm growth to absorb new entrants to the labour force. A 50% increase in non-farm jobs would add 15% to the total number of jobs in the Mekong Delta (and 33% in HCMC) but only 7% in the North Central Coast and 5% in the Northern Mountains. Even though faster growth is often easier from a lower base, it still is hard to add much in absolute terms when the initial position is so small.

The highest incomes were in the areas around the two major cities, HCMC and Ha Noi. The Red River Delta has incomes 40% above its adjoining regions while the HCMC region is 150% above its neighbouring regions. In general, urban wage and self -employment incomes are five to seven times higher than in rural areas. The two wealthy regions also had the highest rate of growth of real spending per capita – 80% for the HCMC area and 57% for the Red River Delta. *These growth rates are double to triple those in other regions, and are likely to draw migrants if the trends continue. A higher growth rate on a larger initial income base will create very large income differentials over time. This will require significant adjustments in policies for those that do move.* Better provision of public services, improving land and capital markets so that more housing gets built, and policies to deal with congestion and pollution will all be needed. However, there is no reasonable way that adequate absorptive capacity can be created if job opportunities are not rapidly generated in areas that are now relatively poor.

In summary, we can agree with the ILO expert, Dr. Muhammad Masum, who completed a review of labour market trends in Viet Nam in February 2000. He concluded, "With the majority of the labour force still in rural areas, it is the rural sector which will have to create a large proportion of the jobs needed to clear up the current backlog of the unemployed and to absorb the new entrants to the labour force… the prospects for continued employment expansion in this [the farm] sector are problematic and *employment generation in off-farm industrial enterprises and services will be critical*"[1]. As we have seen, the household and domestic private non-farm sectors account for over 70% of non-farm employment. Rapid job growth from these sources will be needed to create stability and social harmony, as well as equitable economic progress. If these sectors are so critical, what do we know of them, and their potential and constraints? These questions are addressed in the next section.

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[1] *Social safety nets for vulnerable groups in Viet Nam*, VIE/98/039/ILO. "*Labour market development in Viet Nam in the 1990's*" by Dr. M. Masum, 2/2000, p. 27.

3. Types of Rural Development

Broadly speaking, there are three kinds of rural industrial and service activities.

- Urban spillover: In many cases, the activities from a fast-growing urban sector are transferred to suburban or nearby rural districts where land and labour costs are lower, and inputs might also be cheaper. However, transportation and communication with the central city are still fairly easy. This was the pattern in many of China's town and village enterprises. In China, these rural industries more often sprang up close to the dynamic coastal areas rather than equally all over the nation. Their contacts with modern factories, often with foreign investment, led to their buying new machinery and technology. Some of the secondary growth in Dong Nai and Binh Duong may be of this type. Service, repair, trade, transport, and housing often follow.
- Agro-processing: An obvious line for rural industrialization is to process local raw materials. The "final" product may be semi-finished or a consumer product. Examples are not only coffee roasting or sugar or rice mills but also sawmills for timber, or furniture making. This processing is sometimes done under a contract system with a large central group providing a market and technical assistance to smaller farmers. The areas with a large agricultural surplus have the best chance here, but others may be able to buy nearby surpluses too. In this case too, certain services tend to follow, but perhaps not so densely as in urban spillover.
- Tourism and handicraft: A third route uses traditional skills, often adapted for a larger market, or acquired skills. In Thailand, the large numbers of tourists and their purchases drove this sort of local activity. It ranges from traditional lacquer, silk and ceramic goods to fancy wedding dresses and gem cutting. In many cases, raw materials are brought to the homes or workshops in rural areas for processing and later collected by traders or dealers. Areas getting tourists or lying close to them, or traditional handicraft areas with good marketing, are best able to take advantage of this path. Often the tourists provide important information on tastes and desirable styles of products, and this knowledge can then also be used for exporting.

Of course, there are widely scattered activities such as brick making that can be found all over, but these seldom provide large amounts of employment. The three types of industrial activity just mentioned have the advantage of serving wider markets and allowing a region to develop expertise and specialization. A cursory matching up would suggest agro-processing is likely to be predominant in the Mekong Delta and Central Highlands, though many other regions could also benefit to some degree. Urban spillovers are likely to be most important around HCMC, but also perhaps in parts of the Red River Delta. Traditional handicrafts will probably be initially concentrated around Hue, parts of the Red River Delta, and perhaps the Central Highlands if minorities can produce tourist crafts as around Cheng Mai in Thailand. Other areas can still benefit from the growth of formal private firms, and many of the services growing up around them will also provide opportunities for small-scale industry and services.

It is important not to think about small-scale enterprises only in terms of industry. *Only about a third of household non-farm activity is in manufacturing.* Services include buying and selling, transport, storage, finance, construction, real estate, insurance, hotels, and restaurants. As a community becomes wealthier, it demands more of many of these services as well as better roads, schools, health care, and water supply. If the initial economic impulse is large enough and of sufficient duration, and if the environment is favorable, things may feed on themselves. This tendency to generate self-sustaining growth is perhaps less for aid projects, since they tend by their very nature to end after a while. They may help prime the pump, but they do not keep pumping it.

Another observation is that cities do have advantages. They are closer to densely provided repair, marketing, and transport services. They are themselves a source of demand and therefore attractive to firms that can sell their output locally. In spite of somewhat higher labour and land costs, the availability of information and specialized labour often results in lower overall production costs. It is not surprising that half of current urban residents are migrants, and half of those migrants are from rural areas. (In contrast, nearly all rural migrants are from rural areas, and migrants are only 29% of the rural population). With an urban population approaching one-quarter of the total, it would not be surprising if urban areas absorbed most workforce growth, even if they grew as little as 3-4% a year. The point here is that given the likely importance of cities, it will also be necessary to consider informal urban firms as well as rural household enterprises.

4. Barriers to Entry and Growth

There are several good studies that have listed barriers to small and medium enterprises[2]. Leila Webster's, "SME's in Viet Nam: On the road to prosperity" (Mekong Project Development Facility, November 1999) is a recent one. However, there have been other contributions by the ILO, CIEM, UNDP, World Bank, IFC, and others. This section will mainly try to summarize the existing work, and also use a small number of case studies done especially for this project. Most of the studies come to similar conclusions.

A good way to view the problem of promotion of the growth of small and medium sized private firms is to think of it as a race with several hurdles. The hurdles are somewhat different, and some runners do well with one type or another, but very few are good at jumping all of the hurdles. If the difficulty of at least some of the hurdles can be reduced, then more runners will be able to complete the race faster. A helpful analysis will identify the most restrictive hurdles for the largest number and work to lower those.

Fortunately, there was a 1998 paper[3] that interviewed small and medium sized industries in order to find out which were the most important constraints. The items of most concern were somewhat different for urban and rural firms, and also for household vs. private or partnerships. Even so, a very few stood out. They were:

- Shortage of capital (20% to 40% of firms identified this item)
- Limited demand / too much competition (33% to 55% identified these items)
- Inadequate space (1% to 8% identified this)
- Uncertain government policies (1% to 8% identified this)
- Lack of modern machinery (0% to 4% identified this)

A fuller table in the appendix presents the complete responses.

A common element in almost every list is that the banking and credit system does not work well for many smaller private firms. The state banks resist making loans to private firms, except for routine working capital loans to farmers. There are several reasons. It is hard for even seasoned bankers to conduct a good risk appraisal in Viet Nam, and most state bankers are not experienced or even well trained in such things. They can get

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[2] A small enterprise is one with under 50 employees and with less than VND 1 billion capital, or about USD 70 thousand. A medium manufacturing firm has under 300 workers and VND 5 billion capital, while one in trade or services is medium if fewer than 200 workers and VND 3 billion capital. Household firms are the lowest legal level, usually with only a few workers, while private firms have one owner and 10-20 employees. Higher level types of ownership include partnerships, cooperatives, and limited liability companies.

[3] *The anatomy and dynamics of small scale private manufacturing in Viet Nam,* by Maud Hemlin, Bhargavi Ramamurthy, and Per Ronnas, 1998. The entrepreneurs ranked three options at most.

into legal trouble for making bad loans to private firms, even if they have a good "batting average" and make money overall for their bank. (Bad loans to state enterprises are much less likely to cause legal problems if government or party officials have previously approved them). Spreads between deposit and lending rates have been compressed, so that risky loans may not be profitable. If risk cannot be priced into a loan, it is rational not to take the risk. Bankruptcy law and the ability to attach collateral are not well established, so sometimes a bank cannot collect even if there are assets securing the loan. Nor is there a central credit registry where multiple claims can easily be checked. Land cannot easily be used for collateral by private firms (except for private homes) and only recently could capital acquired by a private firm count towards collateral. Finally, the overall size of the banking system, at about a quarter of GDP, is very small by regional standards and banks cannot lend much in total, much less to the private sector. (In China, bank credit is over 120% of GDP). Although there have been some positive regulatory changes, actual practices have been slower to change. Likewise, savings have been growing faster than incomes, but at current rates of growth it will be many years before banks can play a major role in providing finance as plentiful as in other nations.

The problems of low demand and excessive competition are really the same thing. They reflect on a lack of ability to identify and connect to more distant markets, plus trouble getting the design, quality, and delivery up to standards demanded by consumers. This is true even for more distant markets within Viet Nam, as well as foreign markets. One thing that would help immediately is to lower the cost of communication. Telephone charges are very high and the Internet is not yet a useful tool due to slow connection speeds and high costs for dedicated lines. These are marketing tools, and should be priced and provided at competitive rates and quality. Beyond that obvious step, the efforts of producer associations, chambers of commerce, or marketing firms would be helpful in dealing with groups of companies. Trade fairs in foreign countries could also be opened to private producer groups. These fairs, often supported by government funds or foreign aid, are often confined to state firms. Finally, it may be possible to for groups of private firms to link up with foreign buyers or foreign firms investing in Viet Nam, as these may develop supplier links with these groups. It is important to underline the fact that Viet Nam generally has small markets that can easily be glutted, while export markets are much more likely to demand large volumes. Indeed, the problem in supplying export markets (beyond design, quality control and precise delivery times) may be that the scale of shipments needed is beyond the ability of even a group of small firms to fulfill.

Beyond that, many smaller firms have to deal with state exporters that do not pay for better quality produce or goods, and so end up buying and then selling lower quality items for which they also get a low price. This system does not create any incentives to improve quality, since no buyer is available to discriminate between lower and higher quality goods and pay adequately for the better ones. (In the case of coffee, one foreign exporter buys coffee cheaply and then sorts out the different qualities, making a profit on the good beans while covering costs on the poorest qualities. None of the benefit is transferred to producers).

The land issue was only moderately important in the survey, but appeared as a constraint in over half of the ten case studies. Since the case studies involved medium sized firms, it could be that this issue becomes more important as a firm grows. There is no doubt that land is an issue for many firms, and one that can be solved in a number of ways. Lowering the level at which land reallocation decisions can be made is an obvious one. It should not take a decision by the central government to allow farmland near a town to be used for a factory, especially if only a few hectares are involved. In other cases, it is a matter of extending the period of a lease. In one Quang Ninh village, a shrimp raising enterprise could only get a three-year lease on land, and so kept a low level of investment in extensive operations. If a longer lease were available, the security would allow more investment and an upgrading to semi-intensive operations. Likewise, a fish sauce operation in south central Viet Nam was unable to expand production due to land problems[4]. In many cases, it may be a combination of local unwillingness to allow long-term use rights with restrictive central rules. In one case in Binh Thuan, an owner was denied a land-use certificate because he did not have permanent resident status. This prevents him using his land for collateral. In another case in the Mekong Delta, a coconut byproduct operation had its rent raised by the provincial authorities from VND 0.56 million to VND 4.0 million a year for its 4,500 square meters, for a rental rate equal to half its likely market value. It is not clear what national policies would solve these problems. The attitude of the local governments in these cases seems to prevent these firms from being able to focus on other issues such as technical skills or marketing.

It is noteworthy that relatively few firms thought that a lack of modern machinery was a major stumbling block. At most, about 4% of responses in any group identified this as a barrier, and in urban household, private, and partnership firms the response rate was actually zero. This suggests that programmes aimed primarily at improving machinery may not be very successful, unless they also address other major barriers.

In using these various sources, it is important to keep in mind the vast gap among the different categories of firms. In one survey in 1996-1997 of 914 private firms in and around Hue, nearly 90% did not have a telephone, over 60% did not have a loan, nearly 60% lacked licences of any kind, and 95% had only one owner. Payment was almost entirely by cash (91-95%), except for barter (1-7%). Rural (mainly household) firms had fewer than four workers, including family, while private firms had only 15 workers, of which a third were temporary. Yet these household and private firms accounted for over 40% of all wage workers in the 1997-1998 living standards survey. (A curious category, “other”, accounted for 14% of the total. This probably includes private firms of one sort or another). One way or another small and medium firms account for over half of the non-farm wage jobs available.

Clearly, getting these small firms to grow will take a coordinated effort in which local authorities will have to work with representatives of the private sector and change their orientation from regulators or even extractors to problem solvers and promoters. It

[4] These cases are from the ten case studies made especially for this paper and summarized in the appendix at the end of this paper.

seems likely that the three major problems of credit, marketing, and land will lead most lists of problems, but others will appear in some places and certainly new issues will emerge over time. For example, in some regions getting a key road or reliable electricity may be a top priority. If rapid growth is sustained, finding qualified workers may become more difficult, in which case training would become more important. The point in a report like this cannot be to identify all the problems. It must be to suggest *setting up mechanisms to identify and solve the problems at a local level.* Of course, some problems will require higher level solutions, and those will have to be addressed at a central level. But first getting a flow of reliable information from local governments to the center about the barriers that the firms themselves identify is a way to start.

The central government, of course, cannot provide subsidized credit to many firms, even if they all demand that kind of assistance. However, it can create conditions so that a healthy commercial banking system can grow quickly. It can also make rules that favor the emergence of leasing firms. This would permit market-based credit to be provided to many more enterprises. The government cannot perform key marketing studies itself, but it can lower the cost of quickly contacting those that can provide crucial information. It cannot plan for the necessary imports of particular capital goods or material inputs, but can loosen up import procedures so that those firms can quickly get these goods at competitive prices. However, especially for the smaller firms, the actions of the local government will often be the most crucial. Decisions about land and infrastructure are obvious examples. Moving to equitize locally owned state enterprises that compete with local private firms so that both face similar rules and regulations would also increase confidence that investment might only face market pressures, not discrimination.

5. Summary and Conclusions

This paper has found that creating sufficient jobs for the growing labour force and the existing backlog of those without satisfactory (or any) jobs will be a major challenge. It suggests that farming will play a much smaller role than in the past decade in terms of its ability to absorb workers. There will also be less willingness of young and educated people to engage in farming. Even if formal sector activity expands much more quickly than in the rather favorable circumstances of the last decade, a considerably stronger pace of growth in smaller scale private activity, especially in rural areas and smaller towns, will be crucial to creating tolerable or favorable conditions.

It found the reasons for slow growth in household and private enterprises were mainly related to problems with credit, marketing (finding and satisfying distant markets), and land. However, a number of other factors played a modest role. These included a lack of modern machinery, a lack of technical know-how, uncertainty about government policies, a lack of raw materials, and a lack of transport. Doubtless, many of these issues are inter-related. Taken together, they prevent many small firms from growing or even surviving.

The suggestion was that a two pronged approach be taken. The central government must create conditions so that issues such as the banking system, telephone charges, or the adequacy of the Internet are addressed. Local governments must find ways to communicate with local groups representing private firms and respond to their legitimate concerns, or facilitate the creation of working groups that would allow cooperation among firms in areas such as consumer research, technical standards and knowledge, or quality control. (Some of these may require national or regional level organization as well). By creating a responsive and supportive environment, government can reduce several of the multiple barriers that now inhibit the growth of smaller enterprises. It was also suggested that a more rapid pace of equitization would enhance confidence among private entrepreneurs that government would be even-handed in its dealings, for there is now a sense that state firms receive preferences in access to credit, land, and in other ways. If programmes are created for promoting private sector growth, it is likely that they will be more successful if they can address the range of constraints that actually inhibit growth, starting with the most common and important ones. Highly focussed efforts may not bear fruit if they only fix one problem and ignore others.

Appendices

Appendix 1 Responses to small & medium enterprise survey of constraints to growth

	Households		Private		Urban (Only)	
	Rural	Urban	Rural	Urban	Partnership	Coop
Shortage of capital (%)	35.4	25.5	41.7	31.8	22.5	32.1
Limited demand (%)	28.1	30.6	14.6	13.6	22.5	19.6
Too much competition (%)	20.8	24.5	18.8	34.8	25.0	26.8
Inadequate space (%)	3.1	5.1	2.1	6.1	7.5	1.8
Lack of modern machinery (%)	4.2	0.0	4.2	0.0	0.0	3.6
Lack of technical know-how (%)	0.0	1.0	0.0	0.0	7.5	1.8
Lack of marketing/transport (%)	1.0	0.0	0.0	3.0	0.0	5.4
Uncertain govt. policies (%)	1.0	1.0	2.1	1.5	7.5	1.8
Lack of raw materials (%)	0.0	1.0	6.3	0.0	0.0	0.0
Lack of energy/fuel (%)	0.0	0.0	0.0	1.5	0.0	0.0
Lack of skilled labour (%)	0.0	0.0	0.0	0.0	0.0	0.0
Interference by officials (%)	0.0	0.0	0.0	0.0	0.0	0.0
Difficulty getting licences (%)	0.0	0.0	0.0	0.0	0.0	0.0
Other factors (%)	3.1	2.0	4.2	3.0	5.0	1.8
None (%)	3.1	9.2	6.3	3.0	2.5	5.4

Sources and Notes: The entrepreneurs were to rank three options at most. The survey was taken in 1997. The original source was from *"The anatomy and dynamics of small scale manufacturing in Viet Nam*" by Maud Hemlin, Bhargavi Ramamurthy, and Per Ronnas, 1998. The table was reproduced in and taken from Leila Webster's study, *"SME's in Viet Nam: On the road to prosperity*", Mekong Project Development Facility, 1999, p. 23.

Appendix 2 Summary of case studies

There were ten case studies undertaken for this paper. The researchers visited every region of Viet Nam and found small to medium firms that were successful to some degree, though they also had problems that were slowing their growth. These firms were above the household level, and sometimes larger than most private firms, the lowest legal level above that of household firms. Thus, the studies highlight the problems of firms that have gotten beyond the initial stages of growth and are tending to move to the next level. The table on the following page summarizes salient characteristics about these ten firms, including type of business, location, size, and constraints to growth. A brief discussion of their common and unique attributes follows the table.

Summary of case studies

Activity / Province	Employment	Major Markets	Constraints to Growth
Handicraft / Binh Thuan	400, under contract system	Export	Land, raw material supply, finding new markets
Coconut by-products / Vinh Long	80 full time / 150 seasonal	China, Taiwan	Land, power supply, transport costs, market information
Farm machinery / Nam Dinh	200 full time (5 linked firms)	Domestic, and China	Capital shortage, costs, quality pollution, transport costs
Cafes & Coffee / Buon Ma Thuot	sold through cafes / agents	Domestic	Quality control, machinery, market information & standards

Appendix 3 Case studies of private firms

As part of this paper, researchers wrote up mini-histories of eleven private firms throughout Viet Nam. The research focussed on problems and successes of each firm. Virtually all firms studied are related to agriculture, in part because of the background of the researchers. However, the point of these mini-histories was not to conduct a sample survey but to see if certain patterns of constraints emerged.

In 1998, there were in Viet Nam close to 1.5 million household units, nearly 19,000 simple private enterprises, 7,100 limited liability companies, and 171 joint stock companies. Obviously, it is a big step to move from a small, subsistence unit to even a simple private enterprise, and it is also a big step from there to a joint stock company. Most of the firms surveyed had sales over VND one billion, so they had moved up to the private firm size or even higher. In a sense, the smaller firms are a source of potential bigger firms. But if conditions are harsh, few will be able to make the jump to a higher level, even with good management. But without healthier private firms, Viet Nam's economy will be weak. So it is in the national interest to find ways to allow healthy firms to grow faster.

Before abstracting the major themes, a short summary of basic facts about each firm is provided below.

- Tea processing in Ha Noi / Ha Giang: Started in 1995 with USD 20,000 (VND 200 million) capital, half borrowed. It now has 29 permanent staff and 30 seasonal with USD 30 / month salary, and sells 1,000 tons of tea products valued at VND 12 billion. Only one-fifth of sales are domestic. Export market information, medium term credit, and high advertising rates are seen as problems.

- Shrimp raising in Quang Ninh: Established in 1996, the owner invested VND 300 million to build culverts and drains, and now sells over 2 million shrimp worth VND two billion. He employs four people in management and forty workers. However, a short-term (3-year) contract keeps him from making longer-term investments to allow more intensive shrimp breeding. He would pay a higher land rent if a 10-20 year contract were signed.
- Farm machinery in Nam Dinh: Five brothers jointed in 1997 to combine five firms and 200 employees. They make threshing machines and combined threshers. Working capital is hard to get from bank loans, so they ask for prepayment in return for a discount. Product quality must be improved and prices reduced, while pollution and poor roads remain constraints outside their control.
- Carved wooden furniture in Nam Dinh: The owner's firm grew from just five employees to eighty in several years, and sales are now about VND two billion. Pay is USD 40 to USD 50 a month. Marketing is mainly by word-of-mouth from satisfied customers, even from abroad. Among problems are a lack of information about inputs and outputs, a lack of medium term credit, and unstable supplies of wood.
- Sedge mat production in Thanh Hoa: The owner started in 1988, but was only able to borrow from banks in 1993. Even now, with 50 permanent workers and 200 occasional workers, she must borrow over half of her working capital privately at 2—3% a month. China is one main market, but transport to the border through Quang Ninh can result in fines, and at the border there are only petty sales. Even getting paid is a struggle, since there are no contracts. Getting the right to export directly, and having more market information would also be very helpful.
- Fish sauce in Da Lat / Nha Trang: Starting with only 50 tons of fish sauce in 1987, the owner is now investing to produce 1,000 tons in a few years. His children are studying processing, aquaculture, and business. Markets include both domestic and foreign buyers. There are currently 10 employees and two sales representatives selling to over 1,000 wholesalers. The greatest difficulty is securing land, and the owner may have to move to a different province. He would like more help with marketing (fairs and exhibits are costly) and also easier trade mark registration procedures.
- Coffee in Dak Lak: This owner sought to market high quality coffee through cafes all over Viet Nam. By growing and buying only top quality coffee, and processing it especially carefully, he has built up a dedicated following in several hundred cafes that receive a special license to use their name. (They promise to process the coffee in a special way to ensure quality, and pay him a few million to a few VND hundred million for the name and supply). He would like to expand to international markets, but needs more information and better processing machinery to do that.
- "Buong" leaf production in Binh Thuan: This province has long produced handicrafts from these leaves, but regular markets collapsed at the end of the 1980's. In 1993, the owner joined a work group that collected raw materials and provided them to households for manufacture, checked, and packaged them, and then sold them to one import-export company. In 1995, he signed a contract with a French client for USD 100,000 and in 1996 set up his own company. With a capital of USD 12,000 –

mostly borrowed – for working capital, he was able to employ 70 households directly and provide another 40 with raw materials, which he collects and pays for after they are processed at home. Total employees are over 400, paid about USD 18 a month. He can now (this year) export directly, but has had trouble getting into an important trade fair in China. He is also having trouble with land acquisition, since he lacked a permanent resident certificate. This complicates both his tax and loan situation. Finally, he is running out of raw materials.

- Milk production in Dong Nai: The producer has slowly grown from six cows in 1982 to sixty cows today, producing 9,000 liters of milk a month. His sales are said to be over VND four hundred million a year, and he sells most milk directly to consumers. He also helps other farmers set up milk production and then buys it for distribution. He controls 5 hectares himself and sells any excess milk to another milk company.
- Duck breeding in HCMC: Starting in 1990 with 1 hectare of land and VND 250 million (mostly borrowed from banks), the owner began raising fish and ducks for breeding. He began to raise duck parents and ducklings on the farm, allowing better breeding. He then expanded marketing throughout the Mekong Delta. He now has sales of VND two billion a year. He employs eight permanent labourers and nine seasonal workers. He is now starting to export through a trading company, but is hampered by land restrictions of three hectares per operator. He would also like more extension information.
- Coconut products in the Mekong Delta: In 1992, the owner started using coconut exteriors for making into carpets, brooms, and even organic fertilizer. He got capital from a Taiwanese buyer (USD 95,000) to be repaid either by purchase or providing products. Later, he used his own capital. He has 80 permanent workers and 150 seasonal workers. However, transport is expensive, electricity is often cut off, the land lease fee has been raised sharply, and he has to buy the entire coconut, not just the outsides. This requires selling copra to China, which is risky. He would welcome market information.

This collection of stories shows that there is plenty of entrepreneurial spirit all over Viet Nam. It suggests that capital is available at a price, even when the banks will not lend. If the firm is profitable and grows, it will eventually be able to get short term credit. *However, the toughest problems often transcend the firm: the difficulty in securing land, the problems of good roads and power, and the insecurity of foreign trade.* The frequent requests for market information could be more than a desire for price quotes or addresses of buyers. It could reflect fear of being squeezed by unclear regulations on either side of the border, or of facing large or well-organized buyers who will depress the price of the seller. These firms have sales of USD 0.1 to USD 1 million a year. This makes them quite small by regional standards, even if large by local standards. Small firms can be extremely vulnerable. An article in the June 2000, *Viet Nam Economic Review*, by Nguyen Huu Dat on Viet Nam's private sector makes the point that fewer than 1% of private firms (excluding household enterprises) have *capital* of more than VND ten billion, or about USD 700,000. He notes that only 18% of private firms could obtain medium term credit from banks; that technology is often outdated and skills low; and that land is difficult to acquire. Finally, marketing is hard and sales are mainly domestic. Because of all of these problems, he says that the private sector has been slowing down. However, it may be that the Enterprise Law has allowed at least some firms to become better established. Certainly, seven thousand new private firms were registered in the first half of 2000. Many, though, were probably already in operation and just registered.

Still, the question is if government policies can change from ignoring or even hindering to supporting private firms. The extremely small number of larger private firms (fewer than 700 private firms had over 100 workers in 1999) suggests that there are systemic barriers that government policy could reduce or remove. Easier land policies, use of land for collateral, easier access to trade fairs and marketing information, better organization of private producer organizations, supportive leasing company regulations, lower costs for telephones and Internet, and better infrastructure are all examples that arose even in this brief study. By organizing private producer groups and developing a cooperative working relationship, local and central government could accelerate private sector growth, employ many more people, and help Vietnamese firms compete against firms in neighbouring countries. This will be necessary in the near future.