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DOMESTIC COMPANIES IN VIETNAM: CHALLENGES FOR DEVELOPMENT OF VIETNAM'S MOST IMPORTANT SMES

Markus Taussig*[1]

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* Markus Taussig has worked nearly a decade as a consultant for international development agencies in Vietnam.

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Introduction

Off farm small and medium-scale enterprises (SMEs) are all the rage in Vietnam.[2] Under *doi moi* market reforms of the past two decades, small businesses have proliferated throughout the country, in both urban and rural settings. The position of SMEs has further strengthened in recent years, as an increasing number of entrepreneurs have chosen to register their firms as "companies" rather than the less formal "household businesses.[3]" Foreign donors and Vietnamese government authorities alike have been generous with their praise of the SME sector's contribution to the country's rapid economic growth and its great potential to do much more. This includes helping to address pressing socio-economic issues such as the dearth of wage employment in the countryside. Donors in particular are increasingly backing up their praise with financial support.

But how meaningful is it to speak of—and provide targeted support to—SMEs and an SME sector in Vietnam? Unfortunately, despite the nearly ubiquitous acronym,
The answer is not very. At present, virtually all businesses in Vietnam are SMEs, so the label is not significantly more precise than speaking of the full and highly diverse set of domestic enterprises.[4] More importantly, while the term SME conjures up an image of entrepreneurs struggling to cope with insufficient resources—both commercial and political—its popular use in the Vietnamese context may instead divert attention from more relevant distinctions between the haves and have nots of Vietnamese businesses. More relevant, for example, is the fact that current Vietnamese law and, more importantly under current circumstances, *de facto* administrative practice continue to provide substantially preferential conditions for state-owned enterprises (SOEs) *vis a vis* privately owned counterparts—no matter the relative size of respective firms.

This paper concentrates on the challenges facing further development of Vietnam's most important subset of SMEs: domestic private companies. First, the paper briefly justifies its focus on ownership form rather than firm size through a limited review of the role of SMEs in various countries and a looks at what so-called "pro-SME" policies in Vietnam have meant in practice. Second, it sketches out the current state of Vietnamese private companies before suggesting that the number one priority for sustained, long-term development in the domestic private sector is the *evolution* of predictable rule of law. Quick fixes simply do not exist and can actually prove counterproductive when they lose focus of this core long-term goal. From this perspective, pro-SME policies may be antithetical to the development of rule of law. Finally, the paper concludes with some basic recommendations on how government and donors might more constructively approach the enterprise component of Vietnam's economic development.

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[2] In this report, the word SMEs is used to refer only to non-farm enterprises.

[3] Private companies are here defined as the enterprises that serve as the main focus of Vietnam's Enterprise Law: sole proprietorships (*doanh nghiep tu nhan*), partnership companies (*cong ty hop danh*), limited liability companies (*cong ty trach nghiem huu han*), and joint stock companies (*cong ty co phan*). The overall legal framework for companies is generally clearer than that for household businesses (*ho kinh doanh ca the*), which according to Decree 109 in 2004 are legally supposed to only include firms with less than 10 employees. Companies register with provincial authorities, while households register with the district level. See Taussig and Pham (2004) for more on how variation in government policy across localities in Vietnam has impacted entrepreneurs' decisions of whether to register their firms as companies or household businesses.

[4] The definition of an SME in Vietnam is a firm with less than 300 workers and less than VND 10 billion (equivalent to about US$650,000). For more, see Decree 90/2001/CP-ND "on supporting of development of small and medium enterprises".

SMEs, Economic Development, and Poverty Alleviation

Many development assistance programs promote pro-SME policies based on commonly held beliefs that, relative to larger firms, SMEs: a) increase competition and thus overall efficiency, b) are generally more productive on a per firm basis, and c) are more labor intensive and therefore more effectively address the pressing need for new sources of stable employment for the poor. While anecdotal proof abounds, focused economic research simply does not support any of these arguments.

Testing all three of the above justifications for pro-SME policy, the thorough work of Beck, Demirguc, and Levine covers some 62 countries and finds no proof of any causal relationship between SME development and economic growth or poverty alleviation (Beck et al, 2004). Review of research-based SME literature shows conflicting results and a lack of clear evidence that size influences the impact of enterprises on socio-economic development (See, for example, Hansen, Rand, and Tarp, 2004). The key finding that does emerge is that there is really no alternative to the difficult and slow process of building general market institutions and rule of law.

Vietnam, over the past two decades, has been a prime example of how SME growth can be paired with robust economic growth and dramatic reduction in poverty *without* a clear underlying relationship from the former to the latter. While a correlation does exist between higher company registrations (but not less formal small businesses, such as household businesses) and lower poverty levels at the province level, these formal enterprises are still far too small a part of the country's economy, and far too centered in select urban commercial centers, to be credited with driving what has been an extraordinarily balanced improvement of household income levels throughout Vietnam. Fact is that it is substantially easier to rationalize how broad-based growth in wealth (and therefore available capital for investment and for consumption) produced by Vietnam's high growth and decreasing poverty has led to increased SME activities than the popular efforts to reverse the causal direction of this argument.

Another popular justification for preferential policies for SMEs is the idea that larger companies' voices reach government officials more easily, thus molding lawmaking and implementation in their favor. However, while it is surely true that better off companies in Vietnam also use their resources to gain preferential access and impact policy, it is questionable whether such efforts actually outweigh the political connections of even the smallest state firms. More importantly, the approach of offsetting big companies' political advantages with pro-SME policies is highly indirect and sub-optimal. Attempts to balance one unfair practice with another are rarely successful.

The pro-SME policy arguments rest uneasily on the questionable premise that the advocated initiatives will improve competitive conditions for all SMEs, rather than benefiting only an elite few.[5] Furthermore, it is not clear that, in the Vietnamese context, the main policy aims of

[5] This gets at a complex issue that development organizations tend to be quite uneasy with and generally prefer to gloss over. At Vietnam's current stage of transition, it clearly pays to have connections to the State and, as a result, there clearly also is a privileged subcomponent of the private sector that fosters its ties to government, SOEs, and/or the Party and objects less, at least, to the status quo business environment. In other words, this subcomponent is less "private". Development organizations are

businesses vary significantly with firm size.[6] The small share of Vietnam's domestic private firms too large to be called SMEs tend to be highly competitive, export-oriented firms whose interests are well served by increased transparency and institutionalization of enterprise regulation, which are the very same measures most important to the SME sector (See Webster and Taussig, 1999).

Pro-SME Policy in Vietnam

Donor organizations have nevertheless expended substantial time, energy, and resources promoting the specific cause of SMEs in Vietnam. To some extent, this has probably been due to a belief that to speak directly of private vs. state would be politically incorrect within Vietnam's still nominally communist context. More importantly, however, it would appear to be based on pressures from domestic constituencies in donor countries. Home country constituencies generally make the arguments outlined in the opening paragraph of the previous section and are also influenced by the general sense that: a) when it comes to business, "small is beautiful" and big is oppressive and/or b) using tax payers' money to aid bigger foreign businesses is inappropriate in a competitive global economy.

In practical terms, many donors on the ground in Vietnam would surely argue that SME is used as a synonym for private enterprise. Nevertheless, the difference is not simply an issue of semantics. Politically expedient use of the SME term in Vietnam has real potential to lead practitioners to non-optimal development approaches. A case where this may have already occurred is donor pressure and support for passage of the SME Decree and subsequent creation of the Agency for SME Development (ASMED). ASMED is now a government agency located within the Ministry of Planning (MPI) and is part of a broader pro-SME policy outlined by the ambitious but vague SME Decree. The over-riding theme of the SME Decree appears to be that bureaucrats should be empowered with the resources to promote development of individual small businesses in particular industries. In other words, it perpetuates the old idea that government should choose winners.

ASMED's actual powers and responsibilities, however, are so broadly defined as to have limited meaning in practice. Symptomatic of this counterproductive breadth of mandate is the fact that one of the agency's sub-departments is dedicated to the promotion of *state-owned* SMEs (SOSMEs?).[7] The most unambiguous part of its mandate is its role in partnering with donors interested in financing SME promotion programs. Meanwhile, the agency has no clear authority

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often in the uneasy position where these same firms are best positioned to benefit from the development support targeting private companies.

[6] The author of this paper has opted against cataloguing fully the specific policies that generally comprise "SME Policies" in Vietnam. A strong response to the overall put forth in this paper, however, would show that: 1.) specific "SME Policies" do indeed benefit the average unconnected SME over the average larger private firm (whether connected or not); and 2.) that this greater support for SMEs over larger private firms has a net positive impact on national or regional growth and/or poverty alleviation. The fact that nearly all enterprises are SMEs should not be allowed to stand as sufficient justification for *targeted* assistance to SMEs. It is the opinion of the author that the burden of proof should lie with the advocates of substantial spending of public resources on SME promotion, rather than with its detractors. This opinion, however, does not reflect common development practice.

[7] The presence of a department dedicated to promotion of state-owned SMEs is, in fact, entirely appropriate within the context of donors focusing their rhetoric on SMEs rather than on ownership form. Fully two-thirds (68% in 2002) of all SOEs qualify as SMEs by Vietnam's official definition—which is also very much in line with international definitions on the size parameters of SMEs.

to influence the key longstanding functional institutions that govern actual enterprise activities, such as other relevant ministries (including even other sections within MPI), the Tax Authority, or the court system. Sadly, in the end, ASMED's institutional weakness is probably for the best, given the problematic notion that bureaucrats intervene in the market to pursue activist industrial policy.

Actual SME Development in Vietnam

There have always been some in Vietnam's government who understood the value of competition and private enterprise. Even under the headiest days of central planning, some local leaders regularly looked to entrepreneurs to help make up for the system's failings and meet the people's needs (See Fforde and de Vylder, 1996). The popularity of this practical approach broadened when the explosion of household-based business activity produced by the official sanctioning of private enterprise in 1986-88 proved critical to the political feasibility of necessary subsequent layoffs of state sector workers and soldiers. Growth of private SMEs has been particularly impressive in recent years, following a second wave of reform initiatives in the late 1990s. These reforms, hastened along by both domestic and international negative influences on growth, were highlighted by measures to make it easier for private businesses to register as companies and to sell their products abroad. In effect, more recent reforms have sought to extricate private enterprise from informality, thus setting the groundwork for enterprise rule of law.

While some state-owned SMEs have been shut down as part of state sector reforms, new startups in the domestic private sector have easily overwhelmed such losses to grow the SME sector. Small private Vietnamese businesses now employ at least twice as many people as the state and foreign sectors combined. Employment in the more-narrow category of private companies has also surpassed that of SOEs. This growth in importance of more formal enterprise forms is significant, as companies are subject to stricter regulation of their impact on public goods such as health and labor conditions than are, for example, household businesses.[8] Reflecting their dynamic and labor-intensive nature, these formal firms are now the country's most prolific sources of much-needed non-farm employment creation and, in some provinces (especially in the South), have even surpassed their larger state-owned counterparts in terms of contributions to industrial output and exports (See Taussig et al, 2003). A growing number of private companies have even outgrown the SME label, nearly doubling from 2000 in 2002.[9] This growth beyond the limitations of the SME category is indeed to be celebrated and encouraged—though through means *other than* preferential policies.

Vietnam's government has shown itself to be far more serious about clearing the path for entrepreneurs than it is about privatizing the existing state sector. Indeed, private capital

[8] In Ca Mau province, for example, local government officials report that seafood processing businesses are required to register as companies because this brings them within the existing regulatory system for ensuring basic food safety.

[9] From 2000 to 2002, the number of domestic private companies with 300 or more workers increased from 399 to 757, including 5 with over 5,000 workers (Sourced directly from the Vietnam General Statistics Office, 2004). Included in these numbers are 51 firms in 2000 and 132 firms in 2002 in which the state holds a partial share. This reflects the role of equitization in increasing the number of larger private companies. Still, a substantial majority of new larger private companies appear to indeed be private sector startups.

mobilized by the equitization process since 1992 contributes merely six percent of the capital invested into domestic private sector start ups over the same period (See Vu, 2005, p. 4). While there are clear economic reasons why the government should act more decisively on privatization of SOEs (top of the list being reducing the associated dangers for the financial system and the waste of scare budgetary resources), political risks may be sufficient to qualify the government's *prioritization*, at least, as appropriate and wise. Rapid privatization of the state sector would indeed be complicated and risky. This is less because it might indicate an abandonment of communist principles than it is because, under current circumstances, it would likely lead to the politically connected elite rapidly accumulating former state assets.

Such a development—as seen in many post-Soviet transition states—would probably lead to widespread public dissatisfaction and thereby undermine not only the popularity of the ruling party, but also potentially harm the evolution of nascent market institutions. This perspective is consistent with an emerging literature that stresses the need for relatively mature rule of law prior to large scale privatization in order to mitigate asset stripping and corresponding consequences for political development (Hoff and Stiglitz, 2004). It is also consistent with the highly successful development approach taken in Taiwan, where an authoritarian one-party regime also opted for only incremental steps towards privatization of its sizeable state sector during the first decades of its rapid development (for more on Vietnam-Taiwan comparison, see Riedel and Tran, 1999).

The less encouraging side of Vietnam's private sector development is highlighted by the fact that, despite all the growth in the number of private enterprises and people employed by private enterprises, the domestic private sector remains small and weak relative to state and foreign-invested sectors. While about ninety-percent of workers are employed outside the state sector, only about 10 percent actually earn a wage from a private company. Surprisingly, the domestic private sector's share of (official) GDP has actually *decreased* slightly over the past decade. Even domestic private companies, which have seen the country's highest growth rates in number of firms and employees, have increased their share of GDP by a mere percentage point (from 7% to 8%) over the same period. This would indicate that private companies have simply kept up with Vietnam's impressive growth over the past decade, rather than playing an important driving function. That is, unless the GDP data itself is sufficiently flawed.

One explanation for the disconnect between the rapid growth in private companies *vis a vis* SOEs and the lack of significant corresponding improvement in the relative contribution of private companies to GDP is that not all of the growth from private sector development is captured by official numbers. This is a real possibility suggested by a recent World Bank report that makes use of a capital utilization model that has proven effective—or, at least popular—in calculating unaccounted for economic activity in the former Soviet Union. Basing its conclusions on rapidly increasing electricity consumption, the report found that unrecorded GDP may have increased from 30 percent on top of the official GDP figure in 1997 to more than an additional 50 percent in 2001 (Tenev et al, 2003).[10] If true, this would imply that per capita annual income in the country is nearly $700 rather than the frequently cited $450.[11] If the trend

[10] Further analytical research on the appropriateness of capital utilization models would certainly appear to be warranted.

[11] One of the flaws with this argument, as a way of thinking of unrecorded growth of private companies' contribution to national output, is that there is surely a substantial amount of unrecorded activity occurring from within the state sector, too. State sector

of increasing informality continued over the following few years, current actual annual per capita income might in fact be substantially higher.

Whatever the actual figures, what is clear is that Vietnam's present business environment does not encourage transparent firm-level growth. This is particularly true with regard to tax rates, which remain both at quite high levels and highly variable in their application (For more on tax rates, see Nguyen et al, 2004). A high share of firms pays no taxes at all. Larger firms tend to get substantially more attention from tax officials than do their smaller counterparts. This appears to be particularly true in the less formalized markets of the northern and central regions (Taussig and Pham, 2005). There is also significant anecdotal evidence that successful entrepreneurs in Vietnam prefer to spread their capital across multiple companies, rather than concentrating on individual company growth, specifically in order to avoid what has been referred to as "the tall poppy syndrome". This refers to the idea that the largest, most successful firms get disproportionate attention from local regulators (and corrupt officials), thereby adding substantially to enterprise costs (See Webster and Taussig, 1999). In other words, the system imposes penalties on the rare enterprises that seek to outgrow the SME category. The result is that entrepreneurs are extremely cynical about the role of government and share a pervasive desire to minimize, or completely avoid, official interactions with the bureaucracy.

There is even a lack of transparency regarding the number of enterprises operating in Vietnam, resulting from the confusing diversity of legal enterprise forms. On one end of the spectrum, there are the many small businesses that register under less formal categories or, in some cases, don't register at all. In addition to household businesses, there are even less formal forms such as "production units" (*to san xuat*) and "cooperative units" (*to hop tac*) that are only registered and regulated at the ward level. They are not aggregated into national enterprise statistics. These less formal firms have particularly flexible relationships with local officials that usually involve flat rate payments based on negotiated revenue numbers. On the larger end of the spectrum are plantations (*trang trai*) that are officially owned by the state but allowed to operate much like private enterprises but without the corresponding regulatory oversight. Further complicating the picture are the various not-for-profit organizations, such as scientific research institutes and business associations, actively pursuing entrepreneurial ventures.

The existence of these varied enterprise forms does not appear to be part of a comprehensive plan for enterprise registration and regulation, but instead to be the accidental outcome of an evolution towards a more sophisticated regulatory system. The current effort to bring both private companies and SOEs under one legislative roof via the Unified Enterprise Law being considered by the National Assembly is clearly an important effort to begin to apply a more across-the-board approach. But it is worth noting that there is no current discussion of bringing any of the less formal enterprise forms under this legislation. There also appears to be no interest in bringing collectives under the unified legislation, even though it has been shown that entrepreneurs have easily switched their businesses back and forth between not only company and household business forms, but also between these forms and the collective form.[12] This is

managers often have incentives to under-report economic activity that goes beyond the breakeven point, since this then makes it easier for them to access off-the-books benefits.

[12] This has been shown in numerous surveys. Most recent is the uniquely large scale, three-panel survey funded by Sweden's SIDA and implemented by the Vietnam Ministry of Labor's Institute for Labor Science and Social Affairs, which shows

presumably due to entrenched political interest groups that reap benefits from the status quo of differentiating collectives from worker-owned companies. As a result, it can be expected that entrepreneurs will continue for some time to have a range of different regulatory regimes to choose from when deciding how to package their businesses.

The Key Challenge to Private Sector Development: Rule of Law

Donors, Vietnam's government, and even entrepreneurs themselves tend to emphasize finance, or the lack of, as the biggest obstacle to stronger, longer lasting private sector development. Many among these groups also lament the paucity of quality providers in other important so-called business development services (BDS), such as accounting, management consulting, and market research. The difficulty of accessing market information in Vietnam (whether relating to domestic or foreign markets), in particular, clearly *is* a constraint on investors' ability to make well-informed decisions. The weakness of these services in Vietnam is typically ascribed to so-called "limited capacity", thereby giving value to activities of "capacity building", i.e. training on how best to provide said services.

There is no doubt Vietnam's banking system is in need of substantial reworking, particularly with regard to non-performing loans to SOEs and internal bank incentive structures wherein credit officers are often prone to make decisions not in line with the profit maximizing interests of their employer. Some donor-sponsored programs, for example, have shown training to be of much greater value when directed at private banks instead of state banks, where the state remuneration system allows little flexibility for rewarding an investment officer for overseeing a particularly profitable loan portfolio. Plans for privatization of major state banks, like that of Vietcombank officially planned for 2005, are thus quite important for giving the financial system a chance to work out its problems. Commitments set forth in the US-Vietnam Bilateral Trade Agreement can also be expected to keep shepherding progress along. And yet, no matter the progress, it can further be guaranteed that Vietnam's confident and ambitious entrepreneurs will continue to complain of insufficient funds.

Assumptions withstanding, proof of the direct link in Vietnam between greater availability of capital and private sector development is lacking.[13] More important for the long-term development of Vietnam's private sector and its ability to drive the country's economic growth is how the government chooses to approach the issue of rule of law. For manufacturers, rule of law is key to establishment of the stable, predictable business environment they need to recoup their relatively large initial investments. Rule of law is even more important for services industries, including financial services, which typically must risk substantially broader customer bases than

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significant motion in and out of the collective sector by both companies and household businesses. Fforde has also shown that some collectives are more accurately categorized as non-state than are others (See Fforde and Nguyen, 2001).

[13] Edmund Malesky and the author of this paper are currently working on a paper questioning the common assumption that greater access to bank credit is related to higher levels of private sector activity in Vietnam. Provincial-level statistics and firm-level survey data show that access to capital is not a major issue in provinces with particularly small sized domestic private sectors (See forthcoming paper by Malesky and Taussig to be titled "Formal Credit and Enterprise Formalization in Vietnam" presented at International Convention of Asian Scholars in Shanghai).

their manufacturing counterparts in order to thrive.[14] Current Vietnamese BDS markets, in contrast, tend to be very highly fragmented and informal, in part because of individual suppliers' reluctance to move beyond small circles of familiar buyers. The objectivity of proper rule of law is also of particular benefit to the politically less powerful, those who are unable to bend a more subjective system to their will.

At the very least, rule of law involves the perception of fair and objective design, application, and enforcement of clearly outlined laws. Such objectivity is *not* part of the traditional Marxist-Leninist approach. Even in reforming communism, as expressed in Vietnam and China, the ruling communist party actively oversees and strategically intervenes in the activities of the legislature, executive, and judicial branches in the name of its stated goal on behalf of the proletariat. Reform efforts in Vietnam and efforts to bring about a "law-based state" (*nha nuoc phap quyen*[15]*)* have thus far focused largely on a) slowly—again, very slowly—empowering the National Assembly to emerge as more of an independent force in its drafting of new, more business-friendly pieces of legislation, and b) public administration reform that has emphasized a combination of limited grass roots democracy with increased formalization of powers at local levels of government, particularly at the province level.[16] This focus on the legislative and executive branches is consistent with the Chinese model and has resulted in improvements that give reason for optimism about the future. Where it is most difficult to point to any progress is with regard to evolution of the judiciary—the classic institutional guardian of the rule of law concept.[17]

Vietnam's Economic Court system is, in all practical terms, presently irrelevant to the activities of domestic businesses. In their study of inter-firm transactions and the reliance on informal trust mechanisms, McMillan and Woodruff described Vietnam as "an extreme situation, where the rules of the game have developed spontaneously and the firms cannot fall back on the courts" (McMillan and Woodruff, 1999, p. 2). There is evidence that foreign firms have made concerted efforts to bring cases before Vietnamese courts—and thereby contribute to development of the system—but domestic private companies have proven highly averse to taking such action. Many owners of domestic companies claim that pressing official charges against a business partner—no matter how justified the charge—would be seen as a major violation of behavioral norms and the height of naiveté. The bottom line, they say, is that the likely costs of doing so almost always outweigh the possible, but not very likely, benefits.

It is not clear how many times a domestic private company has brought a case to the Economic Court in Vietnam. As with many statistics in Vietnam, such numbers are not made easily available. Interviews in some secondary provinces make clear that they have had no such cases, while discussions in commercial centers Hanoi and Ho Chi Minh City reveal that the vast majority of cases involve claimants which are either foreign-invested or from the state sector. In

[14] In an economy with established rule of law, a broad, diversified customer base lessens risk. But when rule of law is not yet present, a more diversified customer base can mean that one is less able to apply traditional risk mitigation techniques of developing trust with each individual customer.

[15] For more on this concept and its conflict with the principle of "state economic management", see AusAid, 2000.

[16] Note the difference in this wording from the more popular descriptions of an actual decentralization of governance from the national-level downward. As indicated by the popular "emperor's rule ends at the village gate" (*le vua thua le lang*) saying, local governments in Vietnam have long held substantial informal*, de facto* powers.

[17] In fact, while Article 2 of Vietnam's Constitution divides tasks between the executive, legislative, and judicial branches, it also states explicitly that the three branches are inseparable (Vasavakul, 2002, p. 23).

any case, the Economic Courts are not very busy: in 2003, Hanoi—home to nearly 12,000 enterprises, or one sixth of all the enterprises in the country—saw only 70 cases come to the court (Carlier and Tran, 2005, p. ii). Interviews by the author with the Hanoi Economic Court were unsuccessful in establishing whether any of these cases—and if so, how many—had been brought by a domestic private firm.[18]

When it comes to conflict resolution, domestic businesses in Vietnam tend to rely first on negotiated settlements and second on intervention by local bureaucrats or police. The latter approach, resorted to when the first fails, is most aptly described as a mafia-like arrangement where local authorities threaten some sort of (usually unrelated) administrative action against the accused party in exchange for a negotiated service charge (read: bribe) payment by the aggrieved party. Most entrepreneurs would cynically agree that taking a case to court would involve a similar need to pay, with no greater promise of justice. In both cases, of course, there is also the possibility for the accused to counter with their own corrupt attempt to influence the involved authorities. McMillan and Woodruff highlight the resulting frequency with which Vietnamese entrepreneurs prove willing to renegotiate and compromise with business partners that have violated contracts (See McMillan and Woodruff, 1999).

Any analysis of Vietnam's troubles with development of rule of law, in general, and a functioning judiciary, in particular, must be done with proper acknowledgement of the fact that the country's economic development continues to roll along. Vietnam is, in relative terms, a big success story among developing economies. Entrepreneurs have showed great coping skills and bureaucrats, in many cases, surprising long-term vision in making the highly subjective system work in practice. There may indeed be a higher level of predictability in the Vietnamese system than in any other country at its still very low level of economic development. Nevertheless, the dangers of the status quo are real and are many. The subjectivity of the current system facilitates continued corruption, high transaction costs, and short-term-oriented investment and expansion decisions. The economic crisis witnessed in nearby Thailand and Indonesia in the late 1990s is a crystal clear example of how devastating the consequences can be—particularly for the least politically empowered in society.

Recommendations for Government and Donors

Vietnam's approach to rule of law has been highly personalized and erratic. The revelation that a deputy minister of trade was directly involved in selling highly-sought-after quotas for garment exports proved one of the most intensely covered news issues of 2004. Such cases, aimed at removing the "bad apples," have formed the cornerstone of the government's campaign against corruption and for improving respect for rule of law. Unfortunately, given the widespread belief among the general public that such practices are commonplace, it is possible that such high profile cases simply add to cynicism about the personalized and political nature of the government's approach to law implementation. Vietnamese, in general, seem more ready to

[18] One legal infrastructure development expert interviewed in the process of writing this paper indicated knowledge of two cases brought to the court in Hanoi in recent years. Neither case, however, seemed to have come to a final verdict, potentially because of simultaneous direct out-of-court negotiating by the firms involved.

believe that the accused had angered other powerful officials—perhaps even for not sharing his winnings—than that the case represents a new, higher standard to which all leaders will be held.

International donors have also been susceptible to emphasizing anecdotal signs of progress rather than stressing mundane systemic evolution. Sometimes this desire to identify and promote specific instances of progress even serves to undermine the rationale of systemic evolution. Particularly with regard to popular trends in development, like support for SMEs and BDS, as well as trendy concepts like "clusters" and "competitiveness", donors have frequently found themselves in the questionable position of advocating subjective governance approaches that show preference for particular firms or groups of firms deemed more worthy of development than others. Concrete examples include donor enthusiasm over low or interest-free (i.e. non-commercial) loans to enterprises judged to be "efficient" and efforts to promote preferential regulatory terms for non-commercial entities to compete with private companies in certain areas of commercial service provision.[19]

Quick fix approaches are not constructive. Vietnam's economy is one that has experienced extraordinary expansion *despite* subjectivity, *not* because of it. This reality is reflected in the nature of the formal domestic private sector's development: rapid growth in terms of its contribution to the country's economy, but apparently also rapid growth in terms of the share of it being carried out beyond the reach of basic government regulation and control. It must be stressed that while economists are frequently heard calling for less government interference in the market, only a radical few advocate the degree of *laissez fair* increasingly characteristic of Vietnam with regard to core business regulation issues such as contract enforcement. Again, one need only look back to the regional economic crisis a few years ago for an example of how quickly and how suddenly years of rapid growth can be wiped out when rule of law is neglected.

The failure to focus on rule of law in SME promotion is particularly unfortunate. Focusing on firm size across administrative localities in Mexico, in particular, Laeven and Woodruff found that small firm sizes are often the specifically the consequence of poor legal systems (Laeven and Woodruff, 2004). As noted earlier, smaller firms are likely to benefit the most from greater consistency and fairness in the implementation of business laws because they have the least political clout. Private sector startups also gain particular benefit from a clearer set of rules that does not unduly advantage incumbent industry leaders. The original rationale for SME promotion, after all, is that, under truly fair conditions, these firms would thrive and greatly benefit the economy as a whole. As eloquently written by Riedel et al, the idea is that "their [the SMEs'] beauty is not in their size, but in their profitability (Riedel, 2000, page 71)." Despite this premise, most SME promotion programs have sought to "balance the playing field" by targeting more resources for select SMEs rather than aiming for systematic change in the form of fairer rules on how the game is played. Donors and Vietnam's government are both guilty of this subjective approach—most likely because it is easier and gives the illusion of faster results.

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[19] A representative example is a 2003 UNDP public relations release that commends one particular Vietnamese province not well known for its private sector development success for a new initiative to provide interest-free loans to "efficient" enterprises (UNDP-CIEM, May 23, 2003). Support for the idea that business associations can become be part of the solution for meeting demand for BDS (and lack of corresponding concern regarding "crowding out" of existing or potential private sector providers) appears to be particularly wide spread among donors. A recent World Bank Group/The Asia Foundation report is one example, positing that business associations would make for better business service providers than companies since "they are not in the business of making money … and, as a result, their service fee can be lower and more affordable for members". The report then goes on to suggest that business associations not be taxed on such service provision activities (Nguyen and Stromseth, 2003).

Constructing a system of reasonably predictable rule of law will indeed be very difficult in Vietnam. It will surely not happen quickly and progress may at times be hard to clearly decipher. Even very targeted goals such as development of greater human resources capacity and more appropriate checks and balances within the Economic Court system—not to mention greater trust in said system among domestic entrepreneurs—will require focused, Herculean efforts. In simple practical terms, for example, how is Vietnam to build a talented pool of uncorrupted judges within the context of the current bureaucratic pay scale? Particularly for donors, it is a great challenge to identify when interventions are appropriate and really do move the process along without warping key incentives. The difficulty of the task, however, should provide no cover for programming that seeks short-term anecdotal successes at the cost of longer-term systemic evolution.

Representative domestic institutions of civil society will prove particularly important to informing the actions of both donor and government efforts. Development of truly independent, member-driven business associations, in particular, is key to providing a more diverse chorus of voices representing the shared concerns of enterprises without the political clout to communicate directly with government decision makers. The support provided in recent years by the United Nations Development Program for bi-annual meetings between domestic entrepreneurs and relevant government authorities that model after the system that has worked so well for foreign investors would seem an ideal form of donor intervention. Popular efforts by donors to encourage business associations to provide commercial business services, on the other hand, serve only to confuse the regulatory environment while simultaneously undermining business associations' ability and incentive to effectively carry out their core advocacy role.

In addition to efforts to impact legal development's supply side, donors would be wise to seek ways to stimulate the demand side as well. Some Vietnamese government officials are quick to argue that the infrastructure for commercial dispute resolution is falling into place and that perception among entrepreneurs is simply lagging behind reality. While this claim may be dubious, it clearly points to the benefit of increasing public understanding—and oversight—of government efforts to develop the courts into an effective tool for commercial dispute resolution. A specific donor initiative could, for example, fund a legal team to provide free legal services for domestic private companies looking to take commercial disputes to court. The initiative could then team with print and television business media to get word out on how the court currently handles such commercial disputes. It would be important for any such initiative to maintain a spotlight on each case all the way through implementation of the court's final decision.

Other reports on SME development in Vietnam have advocated increasing targeted support for SMEs, suggesting methods such as SME credit guarantee funds, SME capital funds, and local government-managed SME promotion centers (See, for example, Sakai and Takada, 2000). The information laid out in this paper is intended to raise doubts about the usefulness of such an approach—and indeed to raise concerns of its potential negative impact. Pro-SME policies suffer from a poorly defined target group and focus too heavily on short-term initiatives to correct market failures. In contrast, focusing on broadening and deepening the application of rule of law more effectively targets the end goals of lasting and broad-ranging rationalization of incentives and the way business is done in Vietnam.

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ABOUT THE AUTHOR

MARKUS TAUSSIG has worked nearly a decade as a consultant for international development agencies in Vietnam. His diverse experience has included design and implementation of policy-oriented national surveys of domestic private companies, analyses of local industry clusters, and diagnostic audits of state-owned enterprises. His publications include *Enterprise Formality and the Role of Local Government in Vietnam* (ADB, 2005), *Domestic Private Companies and Vietnam's Pressing Need for Wage Employment* (World Bank, 2002) and *Vietnam's Undersized Engine: A Survey of 95 Larger Manufacturers* (MPDF, 1999).

Markus holds a Masters in International Economics and Southeast Asian Studies from Johns Hopkins' School for Advanced International Studies and has been the recipient of numerous prominent research fellowships, including the Fulbright Fellowship. He will begin a Doctorate in Business Administration with the Strategy Unit at Harvard Business School in summer 2005.