



E P R E S S

Viet Nam: a transition tiger?
Household and private business development

Abstract for chapter 11

Prior to *Doi Moi* the state allowed small-scale non-socialist enterprises to operate in a few industries and services, but restricted private commerce to trade in unprocessed products. During the late 1980s and early 1990s, household business expanded to such an extent that the domestic private sector accounts for most employment and recent employment growth.

This chapter examines how Viet Nam strikes the appropriate balance between the private and public economic sectors, looking at the evolution of a private sector policy with the emergence of domestic private enterprises during the 1990s. Pressures for private sector reform resulted in the Enterprise Law and the text highlights the impact of this law as well as the lessons and issues arising from these recent private sector reform processes.

Keywords:

Central Institute for Economic Management (CIEM), cooperatives, *Doi Moi*, Enterprise Law, enterprise reform, foreign investors, household business, joint-stock, land-use, land-use rights, market economy, multi-sector economy, non-socialist enterprises, private businesses, private sector reforms, socialist sector, Socio-Economic Development Strategy for 2001-10, state sector, the market, Viet Nam Chamber of Commerce and Industry (VCCI)

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HOUSEHOLD AND PRIVATE BUSINESS DEVELOPMENT

THE EMERGING NON-STATE SECTOR

Prior to *Doi Moi*, the domestic private sector largely comprised households engaged in farming, handicrafts and limited retail trade services. At the time of the Sixth Congress, the Party distinguished between a socialist sector (state enterprises, collectives and households) and non-socialist enterprises. The state allowed small-scale non-socialist enterprises to operate in a few industries and services, but restricted private commerce to trade in unprocessed agricultural products (Nguyen Van Dang 2001).

The role of household business in the economy expanded during the late 1980s and early 1990s, and households businesses are now an important contributor to output and employment, especially in the agricultural and service sectors. In contrast, the role of cooperatives has diminished sharply. The 1997–98 Viet Nam Living Standards Survey (VLSS) found that nearly 62 per cent of the population depended on farming (mostly household farms) and another 24 per cent depended on non farm self-employment. Only 25.7 per cent of the labour force was engaged in wage employment. Those engaged in non-farm self-employment generally enjoyed higher living standards than other groups.¹

More recently, there has been a marked expansion in private firms in terms of numbers, employment and output, reflecting significant progress in deregulating domestic private sector involvement in industry and service

activities, and especially in external trade, since 1999. The domestic private sector now accounts for most employment and recent employment growth; dominates agricultural output; and accounts for an increasing share of trade and other key services. Changes in the non-state share of industrial output have been more modest.

STRIKING THE APPROPRIATE BALANCE BETWEEN PRIVATE AND PUBLIC ECONOMIC ACTIVITY

Private sector growth has made a significant contribution to growth and reducing poverty. The key to reducing poverty in Viet Nam has been growth in employment and livelihood options for rural households and the self-employed in the urban informal sector. In Viet Nam, as elsewhere in the region, the number of jobs created for every unit of investment is much greater in the private sector than the state sector.

With capital as a critical constraint, the incentive for the private sector is to maximise output through the adoption of relatively labour-intensive processes. With preferential access to credit and natural resources, easier access to foreign investment, and weaker incentives to maximise profits, Vietnamese state enterprises have invested in more capital-intensive industries, so that typically state enterprises have created fewer jobs per unit of investment.

Thus the private sector has made a particularly strong contribution to employment growth. The private sector absorbed many of the workers laid off from the state sector, and much of the large annual increase in new entrants to the workforce. State enterprises' share of employment fell from 9.3 per cent of the total in 1988 to 5.1 per cent of the total in 1995. The proportion of public servants in the workforce fell from 4.8 to 3.6 per cent over the same period.

Private enterprises are also more flexible and innovative than state sector entities, a factor which is likely to be particularly important in the development of modern manufacturing and service sectors. The life cycle of most manufactured products is limited. Innovation and adaptability are essential to maintain growth momentum. And innovation will be of critical importance in continuing Viet Nam's successful integration into the international economy. Although Viet Nam has had remarkable success in promoting exports, for that process to be sustained, further increases efficiency will be required to effectively

compete in an increasingly competitive international market. Innovation is even more crucial in the modern service sectors.

The growth of a lively and competitive private sector can also act as a stimulus to improved state enterprise performance. Efficiency gaps between state and private enterprises are generally reduced when state enterprises are forced to compete with each other and with suppliers from other sectors (including importers and other domestic producers). As argued above, one reason for Viet Nam's economic success in the 1990s was that, even before the growth of private sector, the state sector was not monolithic; parts of it operated on a decentralised and competitive basis. Measures that promote private sector development and increase the competition faced by state enterprises will contribute to further innovation and growth in efficiency in state enterprises.

Another important reason to promote private sector development is that the government simply does not have the administrative or financial resources to implement manifold commercial business activities while also implementing its ambitious social and physical infrastructure development programs.

The administrative difficulties (for both the government and businesses) of the government being involved in too wide a range of business decisions will become more onerous as the number of business entities needed for Viet Nam to grow and compete increases, particularly in small and medium-scale labour-intensive service and manufacturing activities.

Although the case for encouraging the private sector is strong, this does not imply that a completely *laissez faire* approach is appropriate as a strategy to ameliorate Viet Nam's development constraints. While a strong private sector helps generate growth and reduce poverty, it cannot guarantee an equitable distribution of increased output. Recent poverty studies suggest that, while past patterns of development have greatly reduced poverty, the better-off segments of the population have benefited more than the poorest.

The state needs to continue in a leading role to ensure the equitable distribution of the health and education services, supply the physical infrastructure needed to facilitate the geographical spread of development and service the fast growing urban centres, and should even selectively invest in directly productive activities, where foreign or domestic private investment are not sufficient.

EVOLUTION OF PRIVATE SECTOR POLICY

The movement towards acceptance of a fully active role for the private sector by the Vietnamese authorities has been gradual, and policies have often been ambiguous. There was much more rapid and less ambiguous acceptance of the role of the markets than of the private business. And, for some time, it appeared that foreign private business was more acceptable than national private firms. Household business activity was considered much more acceptable than private firms which employed large numbers of workers. While Viet Nam's Constitution guaranteed that 'enterprises belonging to all components of the economy...are equal before the law' (Government of Vietnam 1995:Article 22), enterprises have not enjoyed equal administrative and regulatory treatment.

Managers of all forms of enterprises were vulnerable to *ad hoc* interpretation of the changing legal and regulatory framework by officials in government and administrative agencies because of ambiguities in public policy. Difficulties also arose because of the rapid pace at which new laws were issued and because regulations were sometimes inconsistent and overlapping; and because the roles, responsibilities and accountability of different government agencies were not clear. There were also counterproductive attempts to regulate far too much.² Consequently, regulations often added unnecessary transaction costs in business and provided opportunities and incentives for corruption.

Early reforms fell short of providing an adequate policy and regulatory environment. This was not only a matter of the regulations as such but also of bureaucratic attitudes. Former Prime Minister Pham Van Dong noted in 1993 that drastically changing society's way of thinking was one of the most difficult aspects of the reform process. The stigma attached to traders under Confucianism, and to any business activity under Communism, 'is not easily undone overnight' (Tuong Lai 1999:5). While some adjustments were made in a surprisingly flexible manner, there were also inevitable tensions.³

Prior to the enactment of the Enterprise Law in 2000, legislation and regulations governing different business entities were promulgated on an *ad hoc* basis to meet the needs of an emerging market economy. Specific legislation was enacted for different categories of owners and for different forms of investment. Restrictions on capital structure were specified for different categories of business entities. Registration responsibilities were spread amongst different government agencies depending on the ownership and form of the

business entity. All this tended to restrict entry and make it difficult to adapt to changing economic opportunities because it limited businesses' flexibility to increase capital and/or change the nature of their activities without going through a costly and time-consuming process of re-registration. Such rigidities hurt smaller enterprises the most because compliance costs were spread over a relatively small base, and this encouraged them to continue operating on an informal basis.

There are a numbers of areas in which private businesses have been constrained by the policy regime. One area in which private business was at a distinct disadvantage was in establishing joint ventures with foreign investors. Foreign investors had an incentive to select a state enterprise as a partner in order to get easier access to decisionmakers in order to facilitate administrative approvals. More direct discrimination included regulations that allowed state enterprises, but not private enterprises, to contribute land-use rights as equity in ventures with foreign investors.⁴ Private enterprises also faced tighter restrictions on transferring land-use rights.

Land has been a constraint on private sector development and remains one of the more contentious ideological issues. The constitution clearly states that all land belongs to the people (that is, it cannot be owned by individuals). However, individuals and business entities can acquire long-term rights to use land. Rights to use land are usually by far the most valuable assets held by Vietnamese households and business entities.

The lack of freehold title to land need not be a constraint, provided that there are efficient markets for trading land-use rights.⁵ This, however, has not been the case. Markets in land-use rights remain poorly developed and inefficient. It is difficult for private individuals or businesses to mortgage, and thus raise finance for investment, from their most valuable asset. Commercial banks are concerned about the difficulties in foreclosing on mortgages in a cost efficient manner to recover bad debts.⁶ Actors in the private sector frequently cite the insecurity of title to land-use rights for commercial and industrial purposes as one of the most important constraints to private investment.

Vietnamese businesses and professionals also have been disadvantaged in terms of access to the latest business, market, trade, and professional literature and information. While controls on access to the internet have progressively been relaxed since late 1997, costs remain high because of monopoly pricing.

While the situation has gradually improved, the costs of international telecommunications, books, newspapers and magazines were higher than elsewhere in the region for the same reason.

During the decade prior to the passage of the Enterprise Law, reforms aimed at promoting private sector development were gradually instituted. A Party Plenum in 1989 called for a multi-sector economy with various forms of ownership and the Seventh Party Congress in 1991 stated that 'the private capitalist sector will be allowed to engage in those businesses prescribed by the law and beneficial to the national economy' (Nguyen Van Dang 2001). Changes to the Constitution (1992) and the Land Law (1993) provided signals to private enterprises that the state was moving towards protecting key property rights.

These policy and legal changes, and associated administrative reforms, helped promote social and political acceptance of the private sector, thus increasing private sector confidence that the reform process would be sustained. Changes in business policies were reinforced by a gradual opening up of economic and social life. People had greater freedom to make their own decisions. By the mid 1990s, permission was no longer required for internal travel⁷ and the number of Vietnamese travelling to market economies on business and to study was growing. Personal contact between Vietnamese and foreigners was much more frequent and only likely to be restricted in exceptional circumstances. There was increased access to international perspectives and experiences through television, movies and other media.

A decisive shift in policy towards actively promoting the development of domestic private sector firms was quite late in coming. A pivotal change occurred with the extensive consultations and public discussion leading to simplification of business licensing and registration requirements during the late 1990s and the enactment of the new Enterprise Law from 2000. Subsequent resolutions from Party plena in 2001 and 2002, and constitutional change (December 2001), have reinforced the legitimacy of private sector firms. The Fifth Party Plenum in 2002, resolved to allow Party members to own private firms. A deputy head of the Party Central Economic Committee summarised the changes as follows

[w]e used to advocate an economy of which a large proportion of output would come from the socialist sector, and wanted to eliminate gradually the non-socialist sector. Nowadays, we have shifted to a multi-sector economy. Many new economic sectors have taken shape, and they co-exist with such conventional ones as the people, collective and private-owned sectors. Each

sector has an important role in the economic structure and serves as a constituent of the socialist oriented market economy. These sectors are allowed to develop, cooperate or compete with one another healthily. An enterprise may contain different forms of ownership. The legal system has gradually shifted to one of general provisions governing all the sectors...

...Previously, we used to believe that central planning was characteristic of socialism and would not accept market relations. Nowadays, we consider the market both the basis and object of planning which is orientative and particularly important in macroeconomic terms. We recognize the market as instrumental in helping enterprises select their scope of production and business plans. Thereby, we have established the elements of the market: goods, services, technology, information services, consultancy, marketing, legal framework, finance, banking, auditing, insurance, capital and labour (Nguyen Van Dang 2001).

EMERGENCE OF DOMESTIC PRIVATE ENTERPRISES IN THE 1990s

Before *Doi Moi*, private business was mostly limited to household businesses, often with uncertain legal status, and operating mainly in the black economy. By the end of the 1980s, however, there were very many traders operating throughout the country, and much small-scale private activity in both urban and rural areas, albeit mostly still without official approval. The number of household businesses increased from about 0.84 million in 1990 to 2.2 million by 1996.

Following approval of the Company Law in 1990 the number of private companies increased steadily, with 190 joint-stock companies, 8,900 limited liability companies, and 21,000 private enterprises registered by 1996.

From the beginning of the *Doi Moi* period the private contribution to light industry, including handicrafts, household and small industries, grew at a lively rate. Most of the former industrial and service sector cooperatives engaged in light industry were disbanded, or reorganised as private enterprises. By 1995, there were over 400,000 production units operating outside the state sector, which generated around 30 per cent of total industrial sector output.

Private businesses have been even more important in the service sector, where they account for about half of total output. They dominate retail trade activity, with their share increasing from 41 per cent in 1986 to nearly 76 per cent in 1996. The state share of the service sector (including public administration, education and health) averaged around 45 per cent through the 1990s. Excluding public administration, education and health, the state accounted for about 22 per cent of value added in services in 1996.

A recently-published survey of developments in small and medium-sized private business between 1991 and 1997 concluded that

[g]enerally speaking, small-scale enterprises in Vietnam were considerably larger and more robust in the 1997 survey than they had been six years earlier. Income, capital and assets have all grown, among the urban as well as the rural enterprises. Furthermore, higher levels of value added per worker unveil growth not only in size, but also in efficiency. The increases in labour productivity are universal and in many instances remarkable. In Hanoi it increased by as much as 70 per cent. This growth has been linked to a general increase in the capital intensity of enterprises. Workers today have much more machinery and equipment at hand than six years ago (Ronnas and Ramamurthy 2001:327).

The lively growth of the national private sector, despite what seemed to be an unhelpful, if not hostile, regulatory environment, has been a particularly striking aspect of Vietnamese development. As noted earlier, casual observations suggest that the rate of private sector growth has probably been considerably greater than that reported in official statistics. In part, this is evidence of the extraordinary vitality of Vietnamese entrepreneurship. This has been demonstrated not only in Viet Nam, but also by overseas Vietnamese in contexts as diverse as North America and the former Soviet economies. It may be that if entrepreneurial 'animal spirits' are strong enough, they can overcome quite negative regulatory environments. A long-established pragmatic culture amongst segments of the administrative system, and amongst political leaders, probably also facilitated entrepreneurial activity.

Thus, somewhat paradoxically, while the regulatory and administrative system resulted in distortions of incentive structures and possibly a sub-optimal allocation of resources, it did not prevent the vigorous growth in non-state economic activity. While the high degree of discretion left to officials in implementing many policies and regulations left the system open to abuses and corruption, it also provided for a degree of flexibility whereby businesses became adept at manoeuvring around regulations and maintaining cooperative relations with local officials.

Observation suggests that, at the local level, many businesses establish close relationships with government and party officials.⁸ Many businesses also have family members who are involved in the public sector. In addition to helping negotiate administrative and regulatory hurdles, this can be important in enforcing contracts and in enforcing property rights. However, it is also apparent that many business people tend to be quite discrete about the degree of their success, not wishing to attract too much official interest.

PRESSURES FOR PRIVATE SECTOR REFORM

The strong focus on employment growth

Grassroots pressure to improve economic opportunities and increase living standards has been important in driving the reform process. Continuing improvements in living conditions were important in sustaining the credibility of the government and the Party, and strong backing of Party and government leaders has helped in removing formal institutional barriers to business development. Agriculture and the household sector presently provide the majority of employment in Viet Nam, but this is generally low productivity, low income employment with minimal growth prospects. The private sector has been seen as crucial to increasing employment and incomes.

During the late 1990s, concerns about the potential impact of the Asian financial crisis and declining foreign direct investment reinforced growing domestic pressures to reduce barriers to private sector development. The Fourth Plenum (December 1997)⁹ called for broader enterprise reform and the introduction of a more consistent regulatory framework for all types of business entities in order to achieve a more level playing field, and announced initiatives to

- amend the law on domestic investment to make it more readily applicable for different forms of enterprises¹⁰
- develop a new enterprise law to apply to a range of different business entities and with more transparent governance requirements
- streamline procedures for business registration, and for issuing residence permits and travel documents, to facilitate business development and employment generation¹¹
- clarify regulations on the inspection and monitoring of enterprises by government agencies¹²
- distinguish clearly between civil and criminal breaches of the law and take strong action to punish criminal business activity
- develop a regulatory environment conducive to healthy competition and establish institutions to resolve commercial disputes in line with the principles of a market economy.

With growing economic turmoil in neighbouring Asian countries, pressure for action had intensified by the time the Fifth Plenum was held in July 1998. This plenum stressed the need for action to mobilise and utilise more effectively

the large amounts of untapped capital still 'under the mattresses' in Viet Nam. There has been increased (or at least more public) policy debate about the positive employment, distributional and equity impacts of small private domestic investments compared with the more capital intensive investments typically made by state enterprises and foreign investors. There has also been more public discussion in the media about the adverse impacts of unnecessary and poorly drafted regulations in facilitating corruption, and stifling investment and employment growth.

Interactions between civil society and the bureaucracy

The growing public debate about administrative barriers to business development reflects grassroots discontent with cumbersome and costly administrative procedures and also the public dissemination of more sophisticated analysis of the equity implications of administrative and regulatory constraints to private sector development by research organisations such as the Central Institute for Economic Management (CIEM), and the Viet Nam Chamber of Commerce and Industry (VCCI).

Public dissemination of information about the employment and equity implications of administrative and regulatory constraints to private sector development have helped increase public awareness of the issues and helped to build support for reform. For example, CIEM produced and widely disseminated a report analysing the experiences with the old Company Law which concluded that cumbersome business procedures are circumvented in practice, encourage corruption, and add unproductive costs to doing business (CIEM 1998). The report drew public attention to the reality that the opportunities for corruption increase as civil servants are given greater discretion in making administrative decisions affecting the profitability of business activities. Given increasing public concern about corruption, the widespread distribution of these findings undoubtedly helped mobilise support for subsequent reform.

As businesses have developed, managers have had to deal with an increasing number of officials from outside established networks in order to secure licenses, pay taxes, secure financing, receive quality certification, and so forth. Business people became more aware of the administrative barriers to enterprise development. This, and the increasing number of entrepreneurs who do not have direct access to decisionmakers, has helped create demand for more

transparent rules of the game. Business people began to see benefits in working with other business people, the Party, government officials, and the media, to push for change. Increased demand for change coincided with more systematic consultation between the state and the business sector to address business constraints.

The VCCI has been the dominant business association in recent efforts to improve the enabling environment for business. The VCCI differs from its counterparts in most market economies in terms of its close relations with the government. Most of its staff have worked with the government, and the government has financed much of VCCI's infrastructure. While external observers may argue that the VCCI is constrained in criticising the state, because of the close links with the Party and the government, at least some domestic business people argue that it is especially effective in presenting business complaints to the government because of its close links with the senior leadership of the government and the Party. It has played a visibly proactive role in pushing for the reforms embodied in the Enterprise Law and related business regulation reforms.

In addition, more independent business associations have begun to emerge which represent the interests of the new private sector (for example, the Young Entrepreneurs' Association) and representing industry interests in dialogue with the government and in public policy debate through the domestic media.

The resolution of the 2002 Fifth Party Plenum

There is now increasing senior level recognition of the contribution of the private sector to socioeconomic development, and increasing top down pressure for change. The Fifth Party Plenum (March 2002) stressed that the private sector is

...an integral part of the national economy. In the past years, the Party and state reform guidelines and policies have enabled the private economy to grow vigorously nationwide, spreading out to all branches and sectors which are not prohibited by laws and have mobilised more social resources in production and business thus generating more jobs and procuring further for the state budget and making an important contribution to GDP growth (Communist Party of Vietnam 2002:n.p.).¹³

The Plenum endorsed measures to create an attractive business climate and a fair and competitive playing field for all enterprises and set priorities for further reform to support private section development, including further

improving the Enterprise Law and reducing remaining barriers to the entry of new businesses; changing the land law and mortgage procedures to make it easier for the private sector to use land-use rights as equity and/or collateral; facilitating lending to the private sector through the provision of guarantees and consulting services; changing the accounting system to encourage private enterprises to adopt professional accounting systems that distinguish more clearly between civil and criminal violations of commercial regulations; asking national leaders to promote the image of the private sector; and allowing business people to retain Party membership.

While these trends represent important progress, much remains to be done. For example, the Fifth Party Plenum endorsed the establishment of business associations, but details of their legal status are still to be resolved. Consultations on business issues are still done on an *ad hoc* basis. Thus, progress in reducing barriers in one area is often (at least partially) undermined by administrative inertia, or new decisions and circulars emanating from line ministries and/or provincial authorities. The Fifth Party Plenum also noted concerns about both the weaknesses of the private sector and problems in ensuring compliance with business regulations, stating that

Vietnam's private economy is basically of small scale and capital and equipped with obsolete technologies, low levels of management and expertise as well as competitive edge. Many private economic businesses have not strictly observed work rules regarding working allowances and conditions for employees; quite a few units have evaded tax or violated laws.¹⁴

The following section describes the process of business regulation reform that was aimed at both promoting private sector development and developing a simplified and more enforceable regulatory environment for business.

THE ENTERPRISE LAW

The consultative processes adopted during the drafting of the new Enterprise Law¹⁵ reflected a crucial turning point in government relations with the business sector. Consultations between government, the business community, the media, and members of the National Assembly were protracted and substantive, resulting in widespread support for, and awareness of, this legislative reform. Reform proposals also included explicit reference to regional experiences with private sector development. The substantive consultations appear to have helped build business confidence that the government and Party were serious in their commitment to private sector development.

The enactment of the Enterprise Law in 2000,¹⁶ and related regulatory reforms, greatly improved the institutional environment for private business. Key implementing regulations (on registering business and cancelling licenses and permits contrary to the Enterprise Law) were issued in March 2000.¹⁷ The net impact of these changes was to help

- reduce ambiguities and inconsistencies inherent in earlier legislation
- provide an umbrella framework for a range of business entities previously governed by different legislation (joint-stock companies, limited liability companies (including corporatised state enterprises), and private firms)
- clarify mechanisms to protect investors and enterprises against state interference in the operations of the enterprise
- simplify enterprise registration procedures
- introduce partnerships as a new form of business
- clarify the rights and interests of company members, and especially the interests of minority shareholders
- clarify mechanisms for decision making within the company structure.
- protect the interests of lenders by clarifying the conditions for withdrawing capital from company
- clarify procedures for profit distribution to protect the interests of shareholders
- define procedures for transferring ownership of non-cash assets
- clarify procedures for merging or breaking-up an entity, and for shifting from one form of entity to another.

In related reforms, the government revoked the need for about 150 business licenses and permits, and simplified many remaining business licensing procedures. While enforcement remains an issue—and many licenses are still required—regulatory reforms have greatly reduced establishment costs and the time required to register businesses. Simplified procedures have reduced opportunities and incentives for corruption, reduced uncertainty about the legality of business operations, and allowed investors to focus their efforts on business development. A very tangible impact of the changes has been the marked reductions in the time lapsing between submission of dossiers requesting business registration, and the eventual approval (from an average of about 90 days to 7 days), and reductions in the typical fees paid to consulting firms for registering a company from about VND 10,000,000 to VND 500,000.¹⁸

These administrative changes were of greatest benefit to smaller enterprises because the costs of complicated procedures are largely fixed: that is they were not related to the size of the enterprise. For small enterprises, these costs could account for a large percentage of their total costs structure. Larger enterprises could spread fixed costs over a larger cost and revenue base. Costs of complex and less transparent regulations were particularly high for those without personal access to decisionmakers in the bureaucracy (for example, firms in isolated and rural areas and firms headed by ethnic minorities, women and other groups that are underrepresented in government). Thus, simplification of procedures helped to reduce the bias against such groups establishing new businesses.

RELATED INITIATIVES GIVING GREATER RECOGNITION TO THE PRIVATE SECTOR

Many initiatives have been introduced since approval of the Enterprise Law which have the potential to improve further the regulatory environment for small enterprises. Since February 2000, private enterprises have been allowed to convert, transfer, lease, provide their assets as collateral and capital contribution to banks or to joint-ventures. The Ninth Party Congress (March 2001) endorsed a Socio-Economic Development Strategy for 2001–10 that included a commitment to move towards equal treatment for all enterprises. A Public Administration Reform Master Plan approved by the Prime Minister in September 2001 is a potentially important step towards addressing remaining administrative barriers to private enterprise development. The December 2001 meeting of the National Assembly amended the Constitution to provide clearer recognition of the long-term role for the private sector in the economy, and formally approved the Socio-Economic Development Strategy for 2001–10.

The strong official endorsement of the private sector appears to have had a significant impact in building investor confidence, and in increasing pressure on those mid-level officials who have been reluctant to implement streamlined business procedures.

IMPACTS OF THE ENTERPRISE LAW

The net result has been a rapid acceleration in the registration of new businesses, including businesses that previously operated in the ‘grey’ economy. During the first year of enactment, 14,444 enterprises were newly registered under the Enterprise Law—about 2.5 times the number of registrations in 1999

under earlier legislation. By the end of 2001, some 35,000 enterprises had been newly registered under the Enterprise Law. Some of these enterprises were already operating informally, but most were newly established. Some existing companies prefer to establish new companies as part of their expansion plans in order to benefit from tax incentives offered to new businesses.

Not only did the number of private businesses grow at a high rate, but their average size and diversity of business activity of sole proprietorship and limited liability companies also expanded. The rate of growth in output by the domestic private sector has exceeded that of both state enterprises and foreign invested enterprises since 2000. Despite this growth, nearly all Vietnamese private enterprises remain relatively small.

The most significant growth has been in the number of new joint-stock companies. The number of joint-stock companies registered in 2000 exceeded the number of joint-stock companies established in the previous nine years. The number of limited liability enterprises newly registered under the Enterprise Law almost equals the total number of such enterprises registered under the old Company Law. The rate of growth in the number of new sole proprietorship enterprises has also accelerated. In addition, some 4,000 existing enterprises increased their chartered capital and/or broadened the scope of registered business activities.

Not only did the number of private businesses grow at a high rate, but the average size and diversity of business activity of sole proprietorship and limited liability companies also expanded. With the rapid expansion in numbers of joint-stock companies, the average registered capital of joint-stock companies declined, from VND 11 billion in 1991–98 to VND 4.2 billion in 2000. Prior to the Enterprise Law there were only a few, relatively large share-holding companies (including equitised state enterprises).

In mid 2001, the Steering Group for Enterprise Law Implementation (SGELI) estimated that the total registered capital of private enterprises had reached VND 24,000 billion (US\$1.65 billion), that newly registered companies have created 300,000 new jobs, and that newly registered sole proprietorship businesses have created another 200,000 jobs.

Prior to the enactment of the Enterprise Law most new enterprises were registered to engage in trading activities. Some 61 per cent of enterprises were primarily engaged in trading services, 26 per cent in manufacturing and processing, 3 per cent in construction, and the remainder in other services and

Table 11.1 Number of newly registered enterprises, 1991–2001

Type of enterprise	1991–98	1999	2000	2001 ^a
Sole proprietorship	26,708	2,427	6,412	2,709
Limited liability company	12,163	3,147	7,304	3,976
Joint-stock company	316	208	726	543
Partnership	-	-	2	0
Total	39,187	5,782	14,444	7,228

Note: ^a First five months of the year.

Source: CIEM and Enterprise Department, Ministry of Planning and Investment.

Table 11.2 Average registered capital of new enterprises, 1991–2001 (VND million)

Type of enterprise	1991–98	1999	2000	2001 ^a
Sole proprietorship	197	400	439	546
Limited liability company	1,006	1,360	1,091	1,276
Joint-stock company	11,832	5,316	4,223	4,923
Partnership	-	-	550	88
TOTAL	542	1,099	959	1,297

Note: ^a First five months of the year.

Source: CIEM and Enterprise Department, Ministry of Planning and Investment.

general business. Following enactment of the Enterprise Law, trading activities still account for the largest share of new business registrations, but the share of manufacturing and other services has increased. Some 42.7 per cent of the businesses registered during 2000 were engaged primarily in trading services, 31.4 per cent were in industry and construction, 3.9 per cent in agriculture and 21.9 per cent in other services and general business. The sector classification system for registered enterprises is still evolving, and thus these numbers should be seen as indicative. However, the figures suggest that private investors are now more prepared to make longer-term business investments.

There is also some indication of more equal regional distribution of newly established enterprises. During the period 1991–98, some 72 per cent of all enterprises were established in the southern provinces, mostly in and around Ho Chi Minh City. While the number of enterprises registered continued to increase throughout the country, the share of newly registered enterprises in the southern provinces fell to 56 per cent of total newly registered enterprises,

while registrations in the northern provinces increased to 32 per cent, and registrations in the central provinces increased to 12 per cent of the total during the first five months of 2001. The acceleration in new registrations in the northern and central provinces is particularly pronounced for the larger limited liability and joint-stock companies (Table 11.3). However, most new business registrations continue to be concentrated in the major cities.

COOPERATIVE SECTOR

Official data suggest that cooperatives played an important role in all sectors prior to the start of *Doi Moi*, accounting for 35 per cent of gross social product in 1985. Cooperatives accounted for 43 per cent of valued added in agriculture, 24 per cent of industry and 18 per cent of general trade in 1987 (see General Statistical Office 1989, 1992). Subsequently, the share of cooperatives fell sharply, with the most rapid declines being in agriculture and trade. By the mid 1990s, cooperatives accounted for less than 1 per cent of GDP.

The role of cooperatives in agricultural production fell to virtually nothing after the 1988 agriculture reforms. The role of cooperatives in industrial output fell sharply after 1988 to about 1 per cent of industrial output by 1994. Most cooperative production capacity was transferred to the private sector. Price reforms, relaxation of restrictions on private sector development, state enterprise reforms, and the loss of East European markets all contributed to reduced incentives for cooperative forms of industrial production.

The 1996 Cooperative Law and the new cooperatives

In response to concerns about the declining role of cooperatives, the government drafted a Law on Cooperatives which was approved by the National Assembly in 1996.¹⁹ The law included provisions for cooperatives to receive up to 50 per cent reductions on land-use rents and taxes for the first two years of operation and preferential access to credit. Family members of cooperative employees, many of whom will also be engaged in the private sector, are to benefit from 50 per cent reductions on tuition fees in government training institutions and from government financed training.²⁰ On the other hand, regulations on inheritance of investments in cooperatives are vague, being largely left to regulations in the Statute of Individual Enterprises. The policy objectives in providing such differential treatment to cooperatives are not specified in the regulations.

**Table 11.3 Newly established enterprises, by region, 1991–2001
(per cent)**

Type of enterprise	1991–98	1999	2000	2001 ^a
Northern provinces	16.9	18.2	28.4	32.1
Private enterprise	6.4	4.4	7.7	7.4
Limited liability company	10.3	12.2	18.4	21.0
Joint-stock company	0.2	1.6	2.2	3.7
Central provinces	11.4	10.4	13.1	12.0
Private enterprise	8.8	6.5	8.3	6.3
Limited liability company	2.6	3.4	4.3	4.9
Joint-stock company	0.1	0.5	0.5	0.8
Southern provinces	71.7	71.4	58.5	55.9
Private enterprise	52.7	30.9	28.7	23.8
Limited liability company	18.4	39.1	27.5	29.1
Joint-stock company	0.5	1.5	2.3	3.1
Total	100.0	100.0	100.0	100.0

Note: ^a Year to June

Source: CIEM and Enterprise Department, Ministry of Planning and Investment.

**Table 11.4 Cooperatives re-registered under new cooperative law
(June 2001)**

	Number prior to new law	Number transformed with business licence	Number transformed but without business licence	Number closed	No action
Cooperatives	9,810	4,250	1,203	1,088	3,269
Per cent of total	100	43.3	12.3	11.1	33.3

Source: CIEM 2001. Report to CIEM Workshop on Implementation of the Cooperative Law, www.ciem.org.vn.

Subsequently, the government issued a comprehensive set of implementing regulations.²¹ The Ministry of Planning and Investment (MPI), the Ministry of Agriculture and Rural Development (MARD), and the Central Union of Cooperatives soon thereafter organised training courses throughout the country to encourage the transformation of old cooperatives, and/or re-registration of cooperatives, under the new Cooperative Law. Steering committees were established at the provincial and at district levels, to facilitate transformation at the commune level. The due date for transforming cooperatives under the new law was 31 December 1998, but many cooperatives had still not been transformed by mid 2001 (Table 11.4).

Newspaper reports indicate that there was more rapid progress in transforming cooperatives in the second half of 2001 and in the first quarter of 2002 (*Viet Nam News*, March 2002). The Fifth Party Plenum in March 2002, was critical of 'the errors of Party organisations and authorities from central down to grassroots levels' in failures to develop the collective economy, and stressed the need to 'accelerate, develop and improve the efficiency of the collective economy' (*Nhan Dan News*, 4 March 2002). The Plenum concluded that

the collective economy and cooperatives are crucial for individual households and small and medium-sized enterprises to lean on each other to survive and grow in the fierce competition of the market economy. The collective economy and cooperatives also constitute a means, which combines with the state economy in addressing social issues, reducing hunger and poverty and raising community awareness...the collective economy should be developed in diverse forms with cooperatives as the mainstay to...guarantee that the collective economy and state economy become the bedrock of the socialist-oriented market economy.

It is not at all clear, however, how realistic these resolutions are (at least in terms of the economic contribution of cooperatives) as the share of cooperative output in GDP was less than 1 per cent in 2000, roughly the same share as in 1996 when the new law was approved. Recent studies indicate that there continues to be ambiguity about the role of cooperatives, the relative roles and responsibilities of cooperative management and members, and of the rights of local authorities to interfere in basic cooperative management decisions (CIEM 2001).

LESSONS AND ISSUES FROM RECENT PRIVATE SECTOR REFORM EXPERIENCES

Informal institutions have played a key role in that rapid expansion of household and micro business in Viet Nam during the *Doi Moi* period. However, as firms grow, and commercial transactions expand beyond village, provincial and national borders, so the demand for more formal institutions grows. But it takes time to develop new institutions and, in planning institutional development, it is important to recognise that new institutions need to reflect local realities and meet demands from the business community. Access to formal institutions, especially if they are 'over-designed', may be very expensive for many entrepreneurs. The challenge is to maximise the benefits from both existing (often informal), and new institutional arrangements. Institutional reform should generally focus on complementing, rather than displacing, existing market institutions.

The recent acceleration in growth of formal private enterprises reflects increasing private investor confidence that an institutional and policy environment is emerging that will protect their property rights. The turnaround in the state approach to private sector development is reflected in the Enterprise Law. While the thrust of earlier business legislation was that private enterprises might be permitted if they complied with government controls, the Enterprise Law codifies mechanisms to protect the rights of citizens to establish and operate private businesses. It also establishes the right of investors to be protected from undue official interference, provided businesses operate legally. Other factors that have contributed to increased confidence over the last 2–3 years include

- a clearer commitment from the country's leadership about the long-term role for the private sector in economic development
- the fundamental change in thinking at all levels of society reflected in the process of recent regulatory reform and drafting of the Enterprise Law
- commitments to the private sector that are increasingly reflected in state policies, legislation and other institutional reform affecting the private sector
- simplified procedures that have reduced opportunities and incentives for corruption, reduced uncertainty about the legality of business operations, and allowed investors to focus their efforts on business development.

REMAINING CHALLENGES

Although the government and Party have left some key questions unresolved about the appropriate balance in the roles of the state, markets and market institutions, ambiguities about the state commitment to private sector development have been reduced in recent years. Meanwhile, accelerated business development continues to contribute to employment growth, and thus to poverty reduction.

The challenge lies in sustaining this progress. This will require continued efforts to address remaining institutional inadequacies that result in high transaction costs and thus constrain business investment and employment growth. Continuing progress in improving consultations between the state and business people will be useful in identifying remaining inadequacies.

Successful institutional reform and development requires broad support. Institutional reform usually results in both winners and losers. Policymakers need to understand the distributional consequences of proposed reforms. In some cases, sustained efforts are required to build support for reforms. Formalising consultative processes and requiring regulatory impact assessments (that also incorporate consultative processes) could add to the quality of new policy and regulatory documents. There is also a need to develop the capacity of research agencies and associations in undertaking applied research, and in preparing policy submissions, on business development issues.

The domestic business media played an important role in securing support for the Enterprise Law, and for complementary regulatory reform. The media could play an increasingly important role in increasing awareness of private sector constraints and business issues, and in providing the greater transparency needed to succeed with anti-corruption efforts.

Learning by doing and by empirical observation have been important inputs into Viet Nam's reform program. Viet Nam has actively studied experiences in other countries in planning reforms, and experiences from more successful provinces have been extended elsewhere throughout the country. Competition between regions for investment can help in developing the most appropriate institutions as it 'highlights successful institutions and promotes demand for them' (World Bank 2001b:4). However, it is also important that such competition does not lead to new distortions in the form of protection and other subsidies for investors.

Regulatory reform has reduced the discretion of civil servants in making decisions affecting business investments. This has the potential to facilitate private sector development and reduce some opportunities for corruption. But there are contradictory tendencies. With a growing role for the private sector, and increased contracting out of the provision of public goods and services to the private sector, improved transparency and accountability in public procurement and policy process is also needed. Otherwise, efficiency gains could be dissipated through new types of corrupt relationships between the state and private sector.

NOTES

- ¹ Vijverberg and Haughton (2002) found that participation in non-farm self-employment was 'associated with a higher standard of living...and...greater economic mobility'.
- ² The proliferation of new decrees, laws and policy reforms may, at least, partly reflect the fact that donors often see such measures as important indicators of success for institutional building technical assistance projects and policy based lending.
- ³ Kornai (1992:579) argues that such tensions are inevitable in post-socialist societies.
- ⁴ Article 11(6) of Decree 85-CP (17/12/96), 'Guiding Implementation of the Ordinance on the Rights and Obligations of Domestic Organisations with Land Assigned or Leased Land by the state', Government Gazette (28/2/97, p.14).
- ⁵ The state retains ownership of land in Hong Kong, and parts of Australia, with land-use rights leased on a long-term basis.
- ⁶ A mortgage sale generally required the consent of the government and mortgagor (Circular 217-NHNN (17/8/96)) and the sale must be conducted by an authorised body (Article 273(2) of the Civil Code).
- ⁷ People still had to register when changing addresses, and some restrictions on moving addresses between provinces.
- ⁸ Officially, Party members were not allowed to engage in private business prior to the Fifth Party Plenum in 2002.
- ⁹ Fourth Plenum of the Eighth Party Congress (December 1997)
- ¹⁰ Amended in April 1998. The Law on the Promotion of Domestic Investment was intended to address concerns of domestic investors that foreign investors received preferential treatment, but cumbersome and ambiguous procedures meant that relatively few domestic businesses applied directly to benefit from the incentives provide under this law.

- ¹¹ Steps were taken soon after to simplify business registration and on the issuance of visas for domestic and foreign business people. Business registration reforms were included in Circular 5/1998/TTLT-KH&DT-TP (10/7/98). 'Procedures for Establishing and Registering Private Enterprises and Companies'.
- ¹² Actions on these issues were reflected in Decree 61/1998/ND-CP (15/8/98), 'Inspection and Control Work with Regard to Enterprises' and Directive 16/1998/CT-TTg (31/3/98), 'Settlement of Enterprise Petitions'.
- ¹³ Resolution of the Fifth Plenum of the Communist Party of Vietnam Central Committee (Ninth Tenure) on Renovating Mechanisms and Policies to Encourage and Facilitate Private Economic Development. See also the Government Action Plan to Implement the Resolution of the Fifth Plenum (Decision 94/2002/QD-Tty, 17/7/02), Cong Bao, Hanoi.
- ¹⁴ A decree addressing this issue was being discussed in early 2002.
- ¹⁵ This section draws on research undertaken as part of the CIEM/UNDP project on 'Improving the Regulatory Environment for Business' which has supported business reforms since 1997.
- ¹⁶ This law replaced the old Company Law and Private Enterprise Law.
- ¹⁷ Decree 02/2000/ND-CP(2/3/00) on registering business under the business law, and Decree 03/2000/ND-CP (2/3/00) and Decision 19/2000/QD-TTg cancelling licenses and permits contrary to the Enterprise Law.
- ¹⁸ Actual costs vary substantially. Estimates are as reported by the Steering Group for Enterprise Law Implementation, and have also been widely reported in the domestic press.
- ¹⁹ National Assembly (3/4/96), 'Law on Co-operatives'.
- ²⁰ Decree 15-CP (21/2/97), 'Policies to Promote the Development of Cooperatives'.
- ²¹ Decrees 02-CP (2/1/97), 15-CP (21/2/1997), 16-CP (21/2/97), and 41 to 46-CP (29/4/97).