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Competition Policy and SMEs in Vietnam

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ABSTRACT

Vietnam stands at an important crossroad in its transition from a planned to market oriented economy. Since the implementation of economic reform starting with Doi Moi in 1986, supplemented with further reform from 1989, the economy experienced rapid economic growth during the period of the 1990s until 1997. Since this time GDP growth has noticeably slowed, partly due to the onset of the financial and economic crisis to afflict the region in 1997-98, and partly due to a disconcerting, and related, decline in foreign direct investment flows. Despite this adverse development there has been a remarkable transformation of the economy that has seen it become more globally oriented, as exemplified by a rapid growth of both exports and imports and with a significant contribution to the economy from the foreign invested sector.

For Vietnam to once again re-establish high and sustainable rates of economic growth will require further restructuring and reform efforts. In particular, this will require further progress in: establishing the institutional framework necessary for a market economy; ownership reform; encouraging foreign direct investment; allowing the private sector a larger role in the management and ownership of currently state owned enterprises; allowing unviable state owned assets to be liquidated and their assets put to more productive usage; and encouraging fair competition between different ownership forms, with the state, as a buyer, not discriminating against any form of ownership. These should form the core of the country's competition policy.

This paper focuses upon the need for competition policy to encourage the nurturing, growth and development, specifically, of private sector small and medium enterprises (SMEs). Private entrepreneurship and enterprise reform can play a crucial role in the reform of the Vietnamese economy. Establishing a dynamic non-state manufacturing sector, with an emphasis on SMEs, will be a precondition for attaining the twin objectives of (1) restructuring and slimming state enterprises and (2) expanding non-farm employment and income opportunities. SMEs have the potential for job creation, contributing to sustainable economic development, allocating resources more efficiently, expanding exports, achieving a more equal distribution of incomes, and assist in rural and regional development.

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1. Introduction

Vietnam stands at an important crossroad in its transition from a planned to market oriented economy. Since the implementation of economic reform starting with Doi Moi in 1986, supplemented with further reform from 1989, the economy experienced rapid economic growth during the period of the 1990s until 1997. Since this time GDP growth has noticeably slowed, partly due to the onset of the financial and economic crisis to afflict the region in 1997-98, and partly due to a disconcerting, and related, decline in foreign direct investment flows. Despite this adverse development there has been a remarkable transformation of the economy that has seen it become more globally oriented, as exemplified by a rapid growth of both exports and imports and with a significant contribution to the economy from the foreign invested sector.

For Vietnam to once again re-establish high and sustainable rates of economic growth further restructuring and reform efforts are required. In particular, achieving further progress in establishing the institutional framework necessary for a market economy, including: the enforcement of contracts; financial discipline and a hard budget constraint on state owned enterprises; establishing the rule of law; and restructuring of the banking sector so that it operates on commercial lines. The country will also be required to make further progress in ownership reform, focusing upon: ensuring free and unrestricted entry to markets for all ownership forms, and the development of a start up private sector; encouraging foreign direct investment; allowing the private sector a larger role in the management and ownership of currently state owned enterprises; allowing unviable state owned assets to be liquidated and their assets put to more productive usage; and encouraging fair competition between different ownership forms, with the state, as a buyer, not discriminating against any form of ownership. These should form the core of the country's competition policy.

This paper focuses upon the need for competition policy to encourage the nurturing, growth and development, specifically, of private sector small and medium enterprises (SMEs). Private entrepreneurship and enterprise reform can play a crucial role in the reform of the Vietnamese economy. There is a recognition that a dynamic non-state manufacturing sector in particular is a precondition for attaining the twin objectives of (1) restructuring and slimming state enterprises and (2) expanding non-farm employment and income opportunities. In particular, the ability to nurture and encourage the development of SMEs is of crucial importance not only in terms of creating employment, but also as a means of achieving sustainable economic development, a more efficient allocation of resources along the lines of the country's comparative advantage, that is labour intensive manufactured goods, expanded exports, a more equal distribution of incomes, and is essential for rural and regional development.

It has been increasingly recognised by regional economies in the wake of the financial and economic crisis that there needs to be a change in emphasis for industry policy. Industry restructuring, with a greater focus upon the development of SMEs has occurred. Unless Vietnam is similarly able to restructure its economy, with an emphasis on the development of SMEs, it will find itself in a relatively weaker competitive position, vis a vis its regional neighbours, to capitalise on the recovery in the region as it gathers pace.

The paper proceeds as follows. Section 2 conducts a review of Vietnam's recent economic performance and the contribution of the private sector to this. Section 3 provides a profile of Vietnam's SMEs. Section 4 identifies strategies for the promotion of the SME sector and for the development of the private sector in general. Section 5 discusses the important role of the Government and the key areas for the support and promotion of SMEs. Section 6 briefly identifies the core ingredients of an effective competition policy. Finally, section 7 provides a summary of the major conclusions from this paper.

2. Vietnam's recent economic performance and the contribution of the private sector

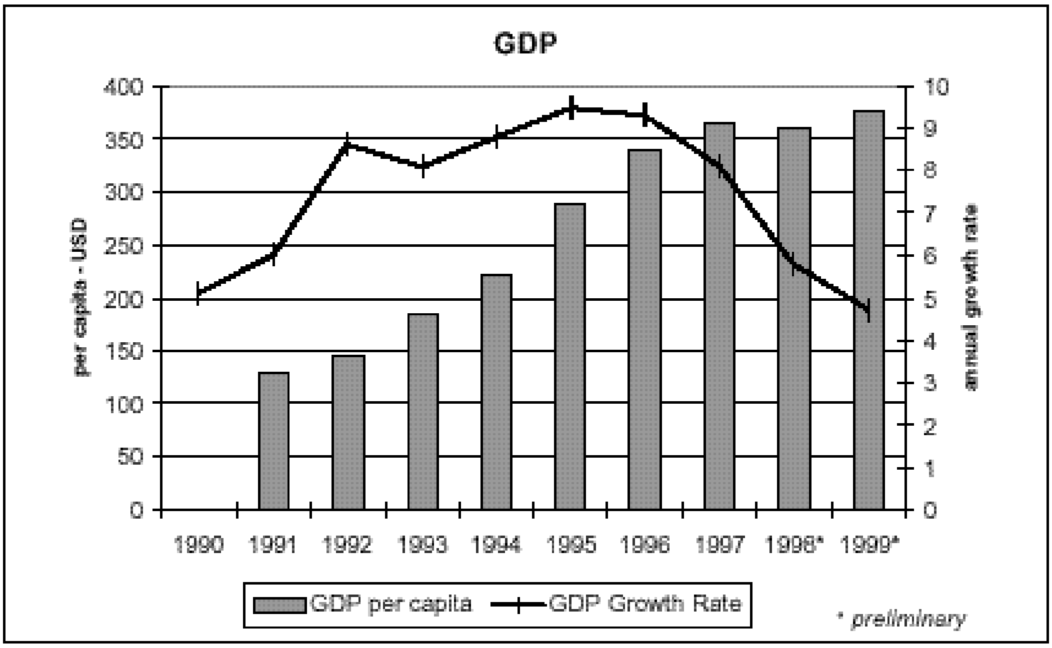
2.1 Vietnam's recent economic performance

During the period of the 1990s Vietnam was one of the fastest growing economies in the world, achieving an annual average GDP growth rate of 7.4 percent. This contributed to a rapid improvement in GDP per capita (see Figure 1). During this period of rapid economic growth there was a noticeable change in the structure of the economy, with the contribution of the agriculture sector to GDP declining from 40.6 percent in 1990 to 23.8 percent in 1999, the GDP share of the industry sector increasing from 22.4 percent in 1990 to 34.3 percent by 1999, and the share of the services sector increasing from 36.9 percent of GDP in 1990 to 41.9 percent in 1999 (see Figure 2). Such a structural transformation is a typical and nearly universal feature accompanying economic development (see for example Chenery and Syrquin (1975)).

On further analysis it can be found that this rapid rate of economic growth was led by the industrial sector. Table 1, taken from Belser (2000), shows that the average annual growth of GDP over the high growth rate period 1993-97 was an impressive 8.9 percent. The major sector contributing to this growth was the industrial sector, where value added increased at an average annual rate of 13.4 percent. The services sector also grew impressively at 9.4 percent a year during this period, while the agriculture sector lagged behind with an average annual increase of 4.3 percent. This accounts for the share of industry and services in GDP increasing relative to that of agriculture. The period of the 1990s has seen a rise in the importance of both the non-state sector and the foreign invested sector in industrial production (see Figure 3). In 1990 the state sector contributed almost 68 percent of industrial production, falling to just over 50 percent by 1995. However in 1999 there was a further decline in its contribution to industrial production, down to just under 44 percent. Therefore over half of industrial production in 1999 was from the private domestic and foreign sectors, with the contribution of the latter, in particular, worthy of note.

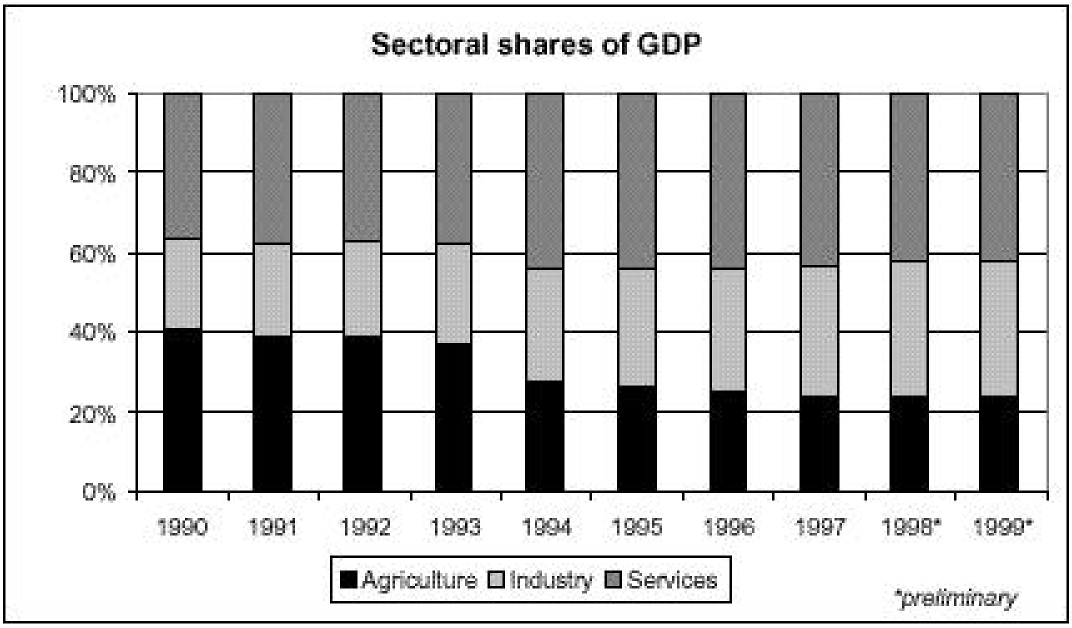
The rapid growth of the industrial sector has contributed to an expansion in industrial employment. Cross-country evidence provided by Gillis et al. (1987) indicates that over the period 1965 to 1983 developing countries experienced on average a growth elasticity of employment in industry of around 0.6. That is, industrial employment expanded at around 60 percent of the rate of industrial growth. In the case of Vietnam, however, industrial growth has had only a moderate impact on employment. As indicated by Tables 2 and 3 the growth rate of industrial employment in Vietnam between 1992/93 to 1997/98 was 4 percent per year. While respectable, this represents

Chart 1.1



Source: *GSO statistical yearbooks and UNDP computation*

Chart 1.2



Source: *GSO statistical yearbooks*

less than 30 percent of the rate of industrial output growth. Consequently, despite the rapid growth of the industrial sector the share of industrial employment in total employment has only increased from 11.8 percent to 13.1 percent. Interestingly, when construction is excluded from the Industry sector, the record is even worse. Hence a key issue for policy makers in Vietnam is how best to benefit in terms of employment growth in the context of rapid growth in the industrial sector. In this regard the contribution of the private sector and SMEs will be of particular importance.

Table 1. Industrialisation of Vietnam

	Average annual real GDP growth during 1993-97 (%)	**Estimated share in total output in 1992 (%)**	**Share in total output 1997 (%)**
Total	8.9	100	100
Agriculture	4.3	31.6	25.2
Industry	13.4	27.3	33.1
Industry less construction	13.1	20.7	24.7
Services	9.4	41.1	41.7

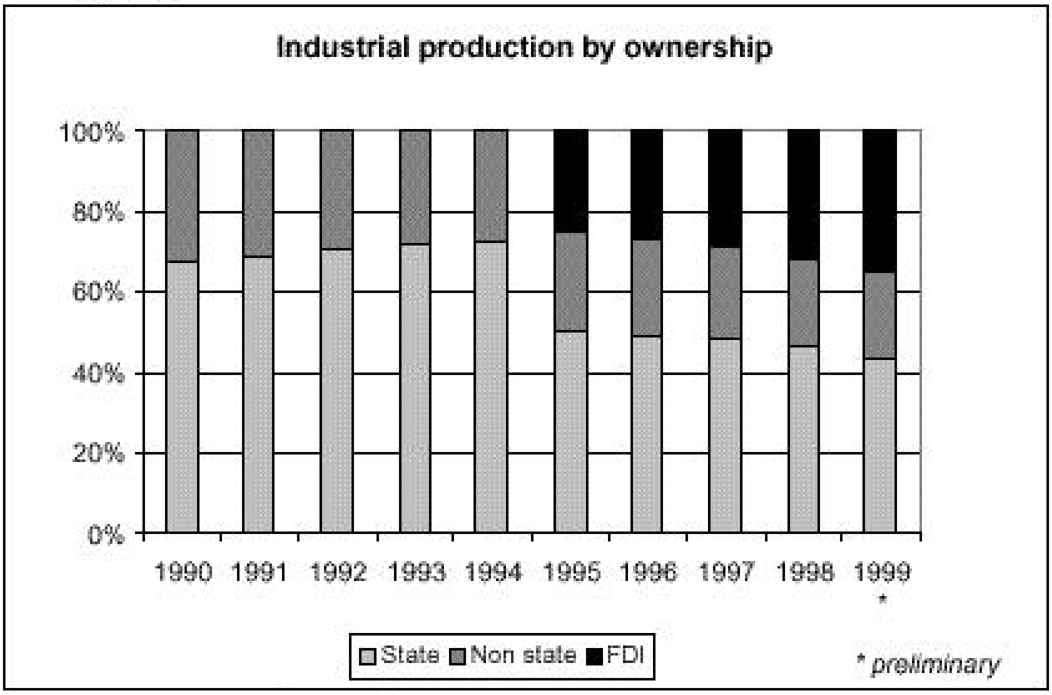
Source: Belser (2000), p.2

There are a number of reasons to explain this sluggish growth of employment, and this can be identified with the aid of Table 4. This shows that in industry the state and the domestic non-state sectors grew rapidly over the period 1995-98. However, it is clear that the state sector dominates the domestic non-state sector, more specifically the private sector. In 1998 the state sector's contribution to industrial value added was more than twice that of the domestic private sector. State enterprises therefore contributed substantially to the expansion of industrial production, amounting to 37.2 percent of Vietnam's total industrial growth between 1995 and 1998. This compared to only 16.2 percent for domestic private companies. Foreign investment, however, was the most important single contributor to expanded industrial production.

By comparison to its contribution to industrial production the state sector's contribution to industrial employment is considerably less. State sector industrial employment was less than 25 percent of total employment in this sector. The domestic non-state sector, by contrast, although contributing only 22 percent of industrial output employed more than 64 percent of industrial workers. A large proportion of these workers were in household enterprises. Of particular interest is the employment contribution of the registered private and mixed companies. Although contributing only 7.9 percent of industrial GDP in 1998 they employed more workers than that of the SOEs.

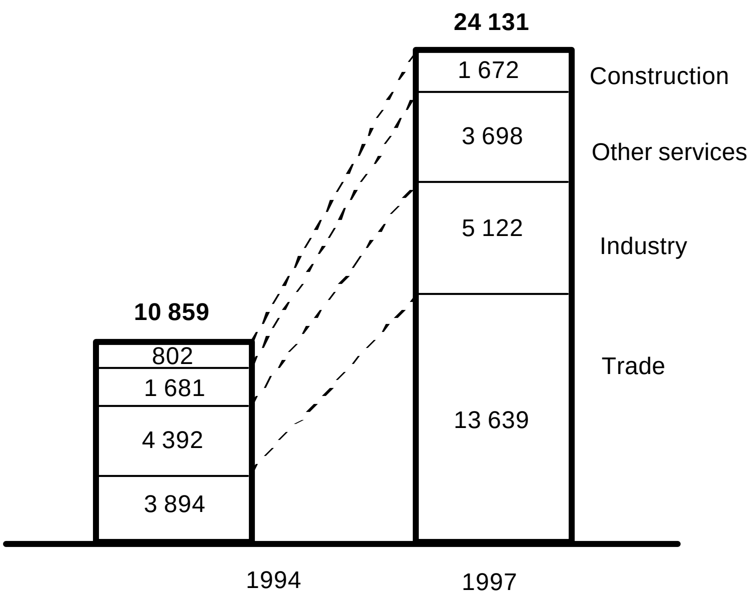
Vietnam's slow employment growth in the industrial sector, therefore, arises from the state sector's strong growth but low labour intensity, and the private sector's still relatively small size. This poor employment performance can therefore be partially explained as a by product of the transition period to a market economy, in which the

Chart 1.3



Source: *GSO statistical yearbooks*

Figure 4. Private Registered Small and Medium Firms



Source: General Office of Statistics

Table 2. Industrial employment growth

	1992-93 (million)	1997-98 (million)	Absolute increase 1992-93 to 1997-98 (million)	% increase per year 1992-93 to 1997-98	Incremental employment distribution 1992-93 to 1997-98
Total employment	36.8	40.3	3.5	1.8	100
Agriculture	26.2	26.8	0.6	0.4	16.7
Industry	4.3	5.3	1.0	4.0	27.0
Industry less construction	3.8	4.3	0.5	2.6	14.8
Services	6.3	8.2	1.9	5.6	56.3

Note: Employment data is for people between 15 and 65.
Source: Vietnam Living Standard Survey, 1 and 2

Table 3. Employment by sector

	Share in total labour force 1992-93 (%)	Share in total labour force 1997-98 (%)	% Change from 1992-93 to 1997-98
Agriculture	71.2	66.4	-4.7
Industry	11.8	13.1	+1.3
Industry and construction	10.3	10.7	+0.4
Services	17.0	20.5	+3.4

Source: Vietnam Living Standard Surveys, 1 and 2.

Table 4. Contribution to industrial production and employment by sector

	Industrial production growth (%) 1995-98	Share in industrial production growth (%) 1995-98	Share in industrial GDP (%) 1998	Share in industrial employment 1997-98 (%)
State sector	10.2	37.2	46.2	24.2
Foreign investment	22.7	46.5	31.8	11.5
Domestic non state sector	9.2	16.2	22.0	64.3
Of which:				
- private and mixed	21.6	11.1	7.9	25.2
- collective	8.7	0.3	0.6	1.3
- households	4.0	4.7	13.5	37.8

Sources: General Statistical Office and Vietnam Living Standard Survey, 2 growth of private enterprises is rapid but overall contribution is small as a result of starting from a much lower base. Also, state enterprises, which tend to be concentrated in import substituting activities and are sheltered from both foreign and domestic competition, typically draw capital and other resources away from the private sector. This could have prevented higher rates of private sector growth and employment, and could be of concern for the attainment of longer-term growth and employment creation.

Another important feature of Vietnam' development process has been the increasing significance of international trade. Table 5 indicates that between 1992 and 1999, for example, the dollar value of imports and exports more than quadrupled, increasing the share of trade in GDP from 52 percent to 58 percent. In 1997 the share of trade in GDP reached a remarkable 86 percent, a high level by international standards. Table 6 indicates that Vietnam's export growth was led by impressive growth in light manufactured exports, which in real terms grew by no less than 45 percent a year and whose share in total exports rose from 13.5 percent in 1992 to 36.7 percent in 1997. Also remarkable is the strong rise in the value of agriculture exports, mainly reflecting the spectacular take off in rice and coffee production. In only a few years Vietnam turned from being a net rice importer into the world's second largest exporter with over 3.5 million tons in 1998.

The performance in manufacturing exports was supported by foreign investment. Vietnam's trade and taxation regimes now contain special provisions that allow export oriented foreign enterprises to import duty free intermediate goods from abroad and to enjoy preferential tax rates. In addition, many joint ventures are also exempted from import duties on equipment goods, machine components, spare parts and transport equipment and materials. Table 7 shows that the dollar value of exports by foreign invested companies, about 40 percent of which stem from light manufacturing, grew by 80 percent per year between 1994 and 1997. This raised the share of exports by foreign invested companies from less than 4 percent in 1994 to almost 20 percent of total exports in 1997.

Table 5. Exports, imports and the share of trade in GDP

Year	1992	1997	1999
Value of exports (million US$)	2,581	9,185	11,500
Value of imports (million US$)	2,540	11,592	11,600
(Exports + Imports)/GDP (%)	51.6	85.7	58.0

Source: General Statistical Office and UNDP.

Table 6. Export growth by sector

	Estimated average annual real growth 1992-97 (%)	Share in total exports in 1992 (%)	Share in total exports in 1997 (%)
Total exports	18.8	100	100
Agriculture	11.1	49.5	35.3
Heavy industry and minerals	12.3	37.0	28.0
Light industry Of which: - textiles and garments - footwear	45.1	13.5	36.7 16.4 10.6

Source: Belser (2000), p.5

Table 7. FDI and its contribution to exports

	1994	1997
Total exports by foreign companies (US$ million)	161.1	1,790
Total light industrial exports by foreign companies (US$ million)	na	728
Share of FDI in total exports (%)	3.9	19.5
Share of FDI in light industry exports (%)	na	21.6

Source: Belser (2000).

2.2 Contribution of the private sector to the economy

The Prime Minister in his opening speech to the National Assembly in November 1999, emphasised the importance of creating a climate conducive to private sector development. Farmers, household micro enterprises, private SMEs and relatively large foreign invested enterprises comprise the private sector in Vietnam. The de-collectivisation of agriculture, together with the approval of the Domestic and Foreign Investment laws in the late 1980s, as well as the Commercial Law in the early 1990s, were extremely effective in promoting growth of the private sector from a negligible base. The economic reforms of the 1980s were remarkably effective in galvanising the energy of millions of Vietnamese individuals who diversified and expanded their agricultural production rapidly, and set up many micro-household-enterprises as well as domestic private registered SMEs. Foreign firms invested in majority foreign owned joint ventures or in wholly foreign owned enterprises. Tapping the potential of individual farmers' drive and dynamism through "Doi Moi" was key to the rapid growth and employment generation of the 1990s (see World Bank (1999)). In the early part of the twenty first century, unleashing the potential of the private non-farm sector, to produce and to export, is likely to be the key to restoring higher growth of income and employment during the next decade.

While systematic data on the performance of the domestic private sector is limited, what does exist suggests a significant expansion and diversification of private sector activities in the last 10 years. Five important facts about the performance of the private sector can be usefully highlighted.

First, the share of the private sector in total GDP in 1998 was about 50 percent, see Table 8, approximately the same share as in 1993. Hence the domestic private sector's share of GDP remained stagnant during this period. During the period 1995-98 the domestic private sector, despite its many constraints, grew at 9 percent a year, only a percentage point lower than the growth of the state owned sector.

Second, less than half of manufacturing GDP in 1998 was produced by private firms, but the share is increasing, with the domestic private sector dominating that share (see Table 8). The domestic private sector, especially household enterprises, has had an important role in manufacturing. Household micro enterprises and private SMEs account for 28 percent of manufacturing GDP. As of 1999 there were around 600,000 micro household enterprises in manufacturing, contributing 18 percent of manufacturing value added, and 5600 private SMEs in manufacturing accounting for 10 percent of manufacturing GDP. However, with the introduction of the Enterprise Law in 2000 the situation was changing rapidly, especially for private registered SMEs, with more than 10,000 new firms registered during the first nine months of 2000.

The period of the 1990s has seen a steady decline in the contribution of the state sector towards industrial output, from around 62 percent in 1990 to 44 percent by 1999 and to just over 42 percent in 2000 (see Table 9). While the domestic private (non-state) share has actually declined during this period the foreign invested enterprises' share has increased considerably. Most of this was due to very rapid growth of foreign invested enterprises in the oil and gas sector as well as in manufacturing. Household enterprise growth stagnated after the first half of the 1990s as the environment for domestic private enterprises was not sufficiently favourable to promote their rapid growth. Thus foreign invested enterprises now have a much bigger share of total private industrial output than was the case in 1990.

Table 8. Private sector's share in 1998 GDP (percent)

	Total GDP	Manufacturing GDP
State sector	49	54
State owned enterprises	na	na
Private sector	51	46
Foreign invested sector	10	18
Domestic private sector	41	28
Of which:		
Household enterprises/farmers	34	18
Private SMEs	7	10

Source: General Statistical Office, Statistical Yearbook.

Table 9. Industrial output: growth and share by sector, 1990-2000

	1990	1995	1999p	2000e
Total industrial growth (%)	3.2	13.8	10.4	15.5
Percent of industrial output				
State owned enterprises	61.7	50.3	43.5	42.2
Domestic private (non state) sector	29.5	24.6	21.8	22.7
Foreign invested	8.8	25.1	34.7	35.2

p – preliminary figure
e - estimate
Source: General Statistical Office, Yearbook.

Third the domestic private sector is considerably more labour intensive in comparison to the state sector and the foreign invested sector. Referring to Table 4 again, it can be seen that in 1998 the state sector contributed 46 percent to industrial production but employed only 24 percent of the industrial workforce. The foreign invested sector contributed 32 percent of industrial production but employed only 11.5 percent of the industrial workforce. By contrast the domestic non state-sector, household enterprises and private SMEs, contributed only 22 percent of industrial production but employed 64 percent of the industrial workforce. The relatively large share of the private sector in employment and in labour intensive exports indicates that it has been outperforming other enterprises in exploiting Vietnam's comparative advantage in labour intensive production. Indeed, private sector development in Vietnam, through its effect on growth and employment, can have a significant impact on poverty reduction.

Fourthly, private SMEs in manufacturing, especially the larger ones, are highly export oriented. In Vietnam there are around 457 private manufacturers with more than 100 full time workers (see MPFD (1999)) that operate mainly in labour intensive sectors like garments, footwear, plastic products, seafood and so on (see Table 10). On average these SMEs export around three-quarters of their production, and consequently have a greater export orientation than SOEs. By comparison foreign invested enterprises export only around a half of their output.

Finally, private foreign invested enterprises are playing an increasingly important role in the economy, accounting for about a fifth of manufacturing output and employing 300,000 workers in 1998. There has been a slight trend away from joint ventures with state enterprises and an increase in wholly foreign owned investments. A large share of foreign investment in industry is in the production of import competing goods in capital-intensive sectors. This is a reflection of the incentives offered to foreign investors in the form of protection to these sectors. In particular, import-licensing restrictions with unlimited protection have encouraged over investment for the domestic market, at the cost of export markets. This structure of foreign investment partially reflects Vietnam's high barriers to heavy industrial imports that not only protect state enterprises but also attracts foreign investors into import substituting and capital-intensive activities, often with SOEs. This form of foreign investment is generally inefficient. It creates local monopolies and raises the price of products relative to those that would have prevailed under free imports. Thus, although foreign investment has boosted local production it has done little to create employment. Improving the climate for export oriented foreign investors would certainly assist Vietnam towards more labour intensive export led growth in line with its comparative advantage.

Table 10. Private registered manufacturers – export orientation

	Number of firms	Exports/Output (%) (unweighted average)
Garments and textiles	159	80.5
Leather products	34	85.0
Rubber and plastic products	22	75.0
Food and beverages (incl. seafood)	71	63.2
Wood products	65	75.1
Other non-metallic products	39	73.2
Basic metals	9	na
Chemical products	9	20.0
Others	49	74.4
Total	**457**	**75.3**

Source: Mekong Project Development Facility (1999)

The adoption of the 1987 Law on Foreign Investment and subsequent amendment established an "open door" policy for investors and increasingly simplified investment procedures. This gradual improvement in the investment climate led to a large increase in foreign capital inflows, mainly from Asian countries. During the period 1993-97 the inflow of disbursed foreign investment increased by almost 46 percent per annum (in terms of current US dollars), reaching nearly US$2.1 billion during 1997. Most of this foreign investment was capital intensive. Although the share of FDI going to light industry has increased in recent years, most investment entered oil related production, heavy industry or real estate. By the end of 1998 less than 13 percent of the total stock of FDI was in the labour intensive light industrial sector, where about 80 percent of production is exported (according to information from the Ministry of Planning and Investment). This indicates that the amount of export oriented and labour intensive foreign investment attracted by Vietnam's high human capital and low labour costs has been relatively small. It is therefore not surprising that foreign investment, while accounting for 31.8 percent of industrial production in 1998, and half of industrial growth over the period 1995-98, employed only 11.5 percent of all industry workers in 1997/98.

Despite a number of favourable developments the private sector remains more constrained in Vietnam than in other countries in the region, including China. The private sector continues to face various unnecessary restrictions on entry arising from the remaining business license requirements, whose modification and rationalisation are still needed. Access to and transactions in land use rights remain difficult despite recent changes in land law and security regulations. New institutional arrangements like registries, and procedures for selling foreclosed land use rights are not in place. Access to capital and credit is also more difficult for private SMEs in part because banks are in dire financial straits, and in part because lending to SOEs is viewed more favourably than lending to the private sector. But improving the climate for day to day operations of private investors - making interactions with the bureaucracy easier- will necessitate deep seated behavioural changes in the way private activity is perceived by the civil service, the dominant state owned commercial banks, and, most importantly, by the political leadership.

3. Vietnam's SMEs - a profile

The Vietnamese economy is characterised by a large number of small and medium sized enterprises with little capital, total SME capital accounts for just 20 percent of the total business capital value of all enterprises, and a small number of state-owned enterprises holding most of the capital of the whole country[1]. More than half of all SMEs are not owned by the state and are therefore, officially at least, private. In practice many companies that appear to be private are really not. "So dominant is the state in Vietnam that the only way to survive is through a network of political patronage" (The Economist (1997), p.46). Before 1988 Vietnam had no private enterprises, "apart from family firms, which were politically above suspicion if only because, at least officially, they did not employ any wage labour" (Wolff (1999), p. 72). There were, however, some enterprises that were run virtually along market-economy lines, particularly in the south of the country. Currently, the most important organisational form of private enterprise is still the household firm, employing an average of 3 employees each (Wolff (1999), p.73)[2]. The next largest element of what Wolff calls *the semi-formal private sector*, are the industrial co-operatives and quasi-co-operative 'production groups' (Wolff (1999)). The number of non-state enterprises has increased dramatically recently[3] and the number of enterprises in the collective and state sectors has tended to decrease. The number of private enterprises, excluding business households or groups working below the limit of legal capital, has been increasing most quickly. Only 5.7 percent of non-state enterprises were established before 1990[4].

3.1 The Number and Structure of Small and Medium Sized Enterprises

In Vietnam, SMEs are officially defined by the Government as enterprises with chartered capital of under VND[5] 5 billion (or US$360,000) and fewer than 200 staff[6]. In 1998 there were more than 30,000 registered enterprises in Vietnam, including more than 23,000 non-state enterprises. Of these registered firms, approximately 22,000 were SMEs. SMEs in Vietnam account for 87.7 percent of the number of State firms, 30 percent of joint ventures, and 96 percent of total private firms in Vietnam. (Central Institute for Economic Management (CIEM), (1998)).

[1] Vietnam had approximately 5300 SOEs in 2000.
[2] Ironically, the Government of Vietnam does not consider family-owned businesses to be private companies (Vietnam News Agency, 2000).
[3] The size of registered capital of these newly established enterprises has been decreasing.
[4] General Statistical Office, 1996.
[5] Vietnamese Dong.
[6] Ministry of Planning and Investment, 1998.

If we classify SMEs by their amount of investment capital (those enterprises with investment capital below VND 5 billion) and by their number of employees (less than 200), then around 90 percent of the total number of enterprises in Vietnam are classified as small or medium sized. Despite making up the preponderance of Vietnamese enterprises the capital value of these SMEs accounts for only 20 percent of the total business capital value of all enterprises[7]. The considerable capital value of the SOEs, particularly the large ones, accounts for this, in addition to the fact that the capital value of the non-state SMEs account for only just over half (52 percent**)** of the total capital value of non-state enterprises.

Figure 4 indicates the growth in number of private registered SMEs over the period 1994-97. In 1994 there were 10,859 privately registered SMEs of which most were in the industry sector (4,392) and trade sector (3,894). While overall industrial growth has outstripped service sector growth, growth in the number of private SMEs has been far higher in services than industry. This reflects the bias in industrial growth in favour of capital intensive and large sized enterprises. Trading SMEs more than tripled in number between 1994 and 1997 (Figure 4)) while those in construction and other services more than doubled. The faster growth of service SMEs is largely because this sector is less dominated by state enterprises and thus experiences fewer restrictions on private participation. In 1997 56.5 percent of all SMEs were in trade and repairing services; 21.2 percent were in the industry sector; 6.9 percent were in the construction sector; and the remaining 15.3 percent in other services. Most (90 percent) of the more than 5,122 SME firms in industry in 1997 were in four sub-sectors: food and beverages (56 percent); garments and shoes (9 percent); metals and metal products (17 percent) and wood and paper products (11 percent). SMEs are typically well represented in sectors in which size and scale are not significant cost advantages. Such activities offer the greatest potential for future expansion of private SMEs (World Bank. 1998, p. 30).

The contribution of non-state SMEs under a number of categories for various economic sectors in 1997 is contained in Table 11 and that for the economy as a whole in Table 12.

Table 11
Contribution of Non-State SMEs in the main economic sectors 1997 (%)

Sector	Capital	Labour	Turnover	Tax payments
Fisheries	55	80	57	87
Processing industry	15	49	22	24
Construction	22	56	33	19
Trade	21	60	42	18
Service & hospitality	19	56	43	63

Source: General Statistical Office, 1998

[7] General Statistical Office, 1996.

Table 12
Contribution of Non-State SMEs in the economy, 1998 (%)

Capital	Labour	Turnover	Tax payments
10.2	47	35	16

Source: Ministry of Planning and Investment, 1999

3.2 Contribution to GDP and production

In Vietnam there are almost no figures available for the contribution of SMEs to the economy. The following is an attempt to draw a general picture of the sector based on data available for economic inputs. In 1995 the share of "value added" produced by the non-state sector to GDP was 65 percent. The contribution of non-state enterprises, including SMEs, to GDP was approximately 36.6 percent. The share of capital value of SMEs in the total business capital value of all non-state enterprises was approximately 52 percent[8]. It is therefore possible to assume that the proportion that SMEs provided of the total value added produced by non-state enterprises was also 52 percent, that is 19 percent of GDP. The share of value added produced by SOEs as a whole is equal to 25 percent of GDP[9]. Assuming that the value added by state SMEs is equal to one fifth of this then the contribution of state SMEs to value added is equal to approximately 5 percent of GDP. Thus, the share of value added produced by all SMEs in the country, in all economic sectors, is estimated to be approximately equal to 24 percent of GDP (see Table 13). This corresponds with the figure of 25 percent of GDP quoted by the World Bank (2001) p.49, suggesting that the proportion of GDP contributed by all SMEs has not changed by much during the latter half of the 1990s.

Table 13
Contribution of Vietnamese SMEs to GDP 1995

No.	Vietnamese SMEs by Ownership	Percentage of GDP
1	Non-state SMEs	19 %
2	State-owned SMEs	5 %
TOTAL		24 %

Sources: Ministry of Planning and Investment, 1998

Tables 4 and 9 indicate that the state sector dominated the industrial sector during the period of the 1990s. However by 2000 its contribution had fallen to 42 percent of industrial production, and foreign invested enterprises, including joint ventures with SOEs, contributed a further 35 percent of industrial production. The domestic non-state sector contributed the remaining 23 percent of industrial production, with the bulk of this being produced by household micro-enterprises. While private registered companies (SMEs), overall, contributed a very small proportion of industrial output, only about 2.4 percent of industrial production in 1997 (Table 14), they were very important in the production of key export items including that of garments and textiles. However, the share contributed by all SMEs (including state SMEs, private local SMEs and those with foreign investment) to the total industrial gross output has been estimated by one source to be equal to 31 percent[10]. However, compared with

[8] Ministry of Planning and Investment, 1998.
[9] General Statistical Office, 1998.
[10] Central Institute for Economic Management, 1998.

other countries in the region, where SMEs contribute on average 50-60 percent of GDP[11], the performance of Vietnamese SMEs remains modest.

Table 14
Distribution of Industrial Output by Ownership (%), 1997 Figures

	Total Industry	Garments	Textiles
State Owned Enterprises	51.4	36.0	60.0
Foreign Invested Enterprises¹	24.4	15.0	16.0
Non-State	24.2	49.0	24.0
Of which: Private companies²	2.4	18.0	14.0

Note: ¹ Includes 100 percent foreign-owned companies and joint ventures with SOEs
² Private registered enterprises and others not in partnership with SOEs
Source: World Bank (1998), Table 2.4, p. 30.

3.5 Contribution to industrial employment

The non-state sector contributes significantly to employment. As indicated in Table 4 the non-state sector contributed 76 percent of industrial employment in 1997-98, with the domestic private sector contributing 64 per cent of total industrial employment. Private SMEs contributed 27 percent and household enterprises contributed 37 percent of total industrial employment in 1997/98 (see Table 15). The World Bank ((2001), p. 49) has asserted that total SMEs for all sectors contribute 50 percent of total labour employment.

Table 15
Industrial employment by sector (%), 1997-98

Ownership	% of workforce
State sector	24
Foreign invested	12
Private SMEs	27
Household enterprises	37

Sources: GSO: Vietnam Living Standard Survey 2, 1999

3.6 Contribution to international trade

As identified previously, Vietnam has made considerable advances in increasing the openness of its economy. Between 1991 and 1995 private firms were allowed to engage in foreign trade by obtaining a license, tariff exemptions were introduced for imported inputs used in the production of exports, licensing procedures were simplified, an inter bank foreign exchange market was introduced, and quotas on exports were removed except for rice. Vietnam signalled its intention to integrate with the region by joining ASEAN in 1995, and is now also seeking membership of the WTO. Since 1998 the trade regime has been opened up further. The most significant measure was the freeing up of trading rights for firms registered in Vietnam. These firms were allowed, for the first time, to export and import goods directly without a license[12]. This newly provided right for domestic firms encouraged significant

[11] Ministry of Planning and Investment, 1999.
[12] For imports: registered domestic firms could only import products that were specified in their

participation of private firms in foreign trade. Domestic private SMEs' share of non oil exports rose from 12 percent in 1997 to 22 percent in mid 2000, Their share of imports increased from 4 percent to 16 percent over the same period (see Table 16). There is therefore considerable potential for an expansion of exports by SMEs, particularly given that they primarily produce labour intensive products that are in line with the country's comparative advantage.

Table 16 Shares in non oil exports and total imports

	Non oil exports		Total Imports	
	1997	Mid-2000	1997	Mid-2000
State owned enterprises	65	46	68	57
Foreign invested enterprises	23	32	28	27
Domestic private SMEs	12	22	4	16
Total	100	100	100	100

Source: Ministry of Trade

3.7 Distribution of SMEs by location

According to Ministry of Planning and Investment calculations, see Table 17, more than 55 percent of the total number of SMEs are located in the Southeast and the Mekong River Delta. The figures for the Red River Delta and the North Central Coast are 18.1 percent and 10.1 percent, respectively. This suggests that there is considerable scope for an expansion of SMEs in the north of the country, where in the past SOEs have traditionally dominated.

Table 17
Distribution of SMEs by Region

Region		Percentage
1	Southeast Coast & Mekong River Delta	55.0%
2	Red River Delta	18.1%
3	North Central Coast	10.1%
4	Other Regions	16.8%
TOTAL		100.0%

Source: Ministry of Planning and Investment, 1998

4. SME promotion and private sector development

4.1 Overview

The Central Committee of the Communist Party of Vietnam has drafted a Socio-Economic Development Strategy (SEDS) 2001-2010 that is "aimed at accelerating industrialisation and modernisation in the socialist orientation and creating a foundation for Vietnam to become an industrialised country by 2020"[13]. This

registration license, and foreign invested firms could not do so until the recent revision to the Foreign Investment Law had eased those restrictions somewhat.

[13] Central Committee of the Communist Party "Socio-Economic Development Strategy 2001-2010 (draft) p.1.

envisages that GDP will double from 2000 to 2010[14]. Vietnam in 2000 faced serious challenges in employment generation with unemployment figures at more than 7 percent, underemployment around 30 percent and an expected growth of the workforce of 11 million people over the next 10 years. Since unemployment and underemployment are the major factors contributing to poverty, the creation of new jobs, and particularly in the rural sector, will be crucial for the reduction of poverty.

To accomplish these aims the SEDS gives particular emphasis to SMEs and private enterprises, especially given their ability to generate employment and opportunities for the poor. In 2000 overall SMEs, both state and private, generated approximately a quarter of GDP, employed around 50 percent of the Vietnamese labour force and were the fastest growing type of enterprise in terms of numbers (see World Bank (2001), p. 49). A flourishing private sector and a growing number of SMEs have the potential to: generate new jobs as well as absorb labour made redundant by the ongoing reform of the SOEs; provide the engine for economic growth; contribute to export growth; and play a vital role in the modernisation and industrialisation of Vietnam. Therefore the government realises that it will be essential, to achieve the targets set under the SEDS, to support the further development of the private sector and SMEs.

Meeting the draft strategy's investment targets will require total domestic private investment having to rise to 11-13 percent of GDP. This is unlikely to occur without a significant improvement in the climate for the private sector, and for SMEs in particular. The climate for the private sector, however, still remains grudging rather than supportive. This contrasts markedly with China where the private sector has been recognised openly as a key partner in the country's development[15]. Despite this there are indications that the climate is improving. In mid 1998 the Law on Promotion of Domestic Investment was revised providing new incentives for the domestic private sector. This was followed by the approval and implementation of the Enterprise Law in 1999 and 2000. Together with the elimination of more than 100 different business licenses that restricted entry in different sectors, ongoing implementation of the Law is improving the policy environment for domestic private SMEs significantly. The Enterprise Law 2000 substantially simplified business start up and led to the registration of more than 10,000 additional domestic firms in the first nine months of 2000. However, domestic private registered firms (private SMEs) still number only around 30,000 and produce less than 10 percent of GDP. Creating a level playing field for the private sector will require a shift in the social and administrative culture from one of reluctance and control towards one of active support and encouragement. The private sector will also benefit from the introduction of a transparent and predictable regulatory framework, where discretionary actions on the part of officials are minimised.

In addition three recent government policies have gone some way to reducing the restrictions on private SMEs. First, firms are allowed to export directly. This will help small firms most of all as they were least able to bear the additional transactions costs of previous restrictions. Second, requirements to import through state enterprises, to satisfy stipulated conditions of capital and qualified personnel needed for being registered as an importer, have been removed. Third, foreign investors are now

[14] Central Committee of the Communist Party "Socio-Economic Development Strategy 2001-2010 (draft) p.6.
[15] See for example Harvie (2001).

allowed to own thirty percent of shares in existing domestic enterprises, permitting private firms to seek foreign partners.

More needs to be done in the area of finance and access to credit for SMEs, particularly for efficient enterprises in rural industry. So far, farmers, SOEs and private foreign firms have driven growth. Private small and medium enterprises have played a negligible role, especially in industry. But private SMEs have been the most efficient users of resources in other countries of the region and key to employment creation. They need to be encouraged in Vietnam. A vigorous private SME sector will need more freedom to operate and better services from a vigorous and modern banking sector, neither of which Vietnam has at present. A precondition for promoting such entrepreneurship will be to introduce reforms to reorient the country's banks towards the needs of private SMEs and to restructure, equitise and liquidate SOEs, to improve their efficiency. A more open trade regime and less import protection for heavy industry will mean more investment in labour intensive sectors and exports (garments, footwear, travel goods, processed agricultural products, tourism), stimulating rural industry and agriculture. While registered private firms can export or import more easily, registration of private businesses, a prerequisite for trading, still remains difficult.

The most cost effective prospect for generating off farm employment is through promoting SMEs (i.e. registered private companies with 50-300 employees) Each job generated in an SME is estimated to require a capital investment of about US$800 (VND 11 million, in book value). In contrast, one job created in an SOE requires approximately US$18,000 (VND 240 million). Empirical evidence from other countries also indicates that SMEs are more efficient users of capital under most conditions[16].

During the early period of reform in the late 1980s agricultural growth, made possible by allowing farmers greater decision making freedom, was the main engine for Vietnam's initial surge of growth. Eliminating the existing restrictions on SMEs has the potential to result in a second round of growth by boosting labour intensive manufactures and processed agricultural exports, thereby protecting rural areas from the current slowdown. So far private SMEs (i.e. registered corporate firms) have played a minor role in industrial production, contributing only two percent of industrial output, and have grown very slowly. Household enterprises play a much larger role. This contrasts sharply with the experiences of its rapidly developing regional neighbours.

4.2 Promoting Vietnam's SMEs

Despite an improvement in the private sector business environment its growth and development still remains more constrained in Vietnam than in other countries of the region, including China. For example, the private sector continues to face various unnecessary restrictions on entry arising from remaining business license requirements, whose modification and rationalisation are still needed. Access to and transactions in land use rights remain difficult despite changes in land law and security regulations. New institutional arrangements like registries, and procedures for selling foreclosed land use rights are not in place. Access to capital and credit is also

[16] See World Bank (1998), pp 29-30).

more difficult for private SMEs in part because banks are in dire financial straits and in part because lending to SOEs is viewed more favourably than lending to the private sector. But improving the climate for day-to-day operations of private investors by making interactions with the bureaucracy easier, will necessitate deep-seated behavioural changes in the way private activity is perceived by the civil service, the dominant state owned commercial banks, and, most importantly, by the political leadership.

According to a recent survey by the Vietnam Chamber of Commerce and Industry (VCCI (1999)), the main difficulties encountered by SMEs in Vietnam are:

- The majority (80 percent) lack capital for production and trade.
- Most have obsolete equipment and machinery.
- They lack adequate physical and human resources.
- They lack current information on technical, market and legal issues.
- They lack support from the state, especially in technology transfer, credit guarantees and loans.

In this section four of these issues are given particular focus: access to finance; access to technology and use of information technology; access to market information; and human capital deficiencies. Each of these is now briefly discussed in turn.

4.2.1 Access to finance

Government policies on mobilising financial resources have been implemented through taxation, interest-rate management, and investment promotion strategies. Domestic production did develop rapidly in the first half of the 1990s as did domestic savings and gross investments. From 1991-1995 domestic private investment (mainly by SMEs) accounted for 30 percent of total gross investment (approximately equal to US$6 billion). The remainder of the capital for enterprises was mobilised from formal domestic and international institutions.

Despite the increase in investment nearly all (80 percent) of Vietnamese SMEs lack capital for production or business, according to official statistics (Ministry of Planning and Investment, (1999)). According to a survey of SMEs conducted in 1999 by the Vietnam Chamber of Commerce and Industry (VCCI): 55 percent of enterprises had difficulty in obtaining capital; 67.5 percent of enterprises had to borrow from relatives and friends; 25 percent of enterprises had to deliver materials in advance; only 42.5 percent of enterprises borrowed from the banks; and 20 percent of enterprises borrowed from other financial organisations (VCCI (1999)).

Other surveys of SMEs by government management agencies and other organisations give similar results. These surveys also pointed out that the share of bank loans allocated to the non-state enterprises has tended to increase, but not in accord with their number and their contribution to GDP. For instance, bank loans to these enterprises, as a proportion of total loans, were: 10.3 percent in 1990, 18.2 percent in 1992, 33.1 percent in 1993, and 37.1 percent in 1994 and 50 percent in 1995[17]. However, this has not satisfied the demand for credit by non-state enterprises. The

[17] Sources: State Bank of Vietnam, Ministry of Finance, Central Institute of Economic Management.

financial system can satisfy only 25.6 percent of the credit demand by the non-state enterprises. According to CIEM, in 1995, among 407 SMEs surveyed, 316 had to borrow from informal financial sources.

Difficulty in accessing financial resources by SMEs has partly resulted from the obstacles created by some of the policies and regulations on capital mobilisation. The effect of these policies has been as follows. First, the majority of external resources, such as Foreign Direct Investment and Official Development Assistance, have been allocated to the state sector. Second, there are still irrational regulations that seriously hamper the capital mobilisation of SMEs. For example, the regulations on short-term credit issued by the State Bank give preferential treatment to the state-owned enterprises, which enjoy cheaper financing in comparison to their counterparts in the private sector. Compulsory insurance is also unreasonably required for those assets financed by bank loans, even when such loans had not yet been given by the banks and when the ownership documents related to the assets are not available. Collateral for bank loans is required for non-state enterprises while it is not for SOEs. There is still no guidance document available on collateral procedures. According to Decision 198/NH on 16 September 1994 by the State Bank and Decision 217 on 17 August 1996, the maximum bank loan is defined to be equal to 70 percent of the value of the collateral written in the loan contract. However, in practice, enterprises are given loans equal to less than 50 percent of collateral, regardless of the fact that the asset values determined by the banks are usually different from the actual values. Third, there are no special financial institutions for SMEs, except for a number of foreign funds such as the SME Development Fund, which operates through the existing commercial banks, and the Mekong Project Development Facility (MPDF) that mainly provides technical assistance for private sector SMEs.

4.2.2 Access to technology and use of information technology

Technology and equipment in SMEs

A draft development strategy for SMEs prepared by the Ministry of Planning and Investment (MPI, 1999) indicated that their technology level, as well as the nature of their equipment and machinery, was in poor shape. Moreover, the rate of renovation is too low, approximately at the level of 10 percent of annual investment. The strategy document proposed, in order to improve conditions for the development of technology, that:

- Competition should be created to encourage enterprises to adopt new technology and renovate existing technology;
- The economy should be open to access and exchange information;
- Enterprises should be encouraged to improve their capacity to apply new technology.

Presently, the majority of Vietnamese enterprises, especially SMEs, are using obsolete technology that is perhaps 3 or 4 generations behind the world's average level. Their technological and technical capacity is limited, and the capital level per employee is low (only 3 percent of the level in the large industrial enterprises)[18].

[18] Ministry of Planning and Investment, 1999.

In a recent survey by the Central Institute for Economic Management, specialists in government organisations and other SME support institutions recognised that the technology level in SMEs is obsolete, that technology management skills are poor, and that product quality is low. At the same time the government has not provided supporting policies for technological advance. Among 40 enterprises surveyed only 2 had been able to get any technological support[19]. Policies that support the enhancement of technology for SMEs have many weaknesses. These are:

- There are no policies specific to SMEs (that is specific policies on training and improving the skills in management, technology, etc.).
- No research and development organisation has been created specifically for SMEs.
- The specialised organisations in science, technology, and training that exist are not strong enough to provide the supporting and consulting services required for SMEs;
- The existing promotion centres were established mainly to meet the requirements of international assistance projects rather than to satisfy the need to support SMEs.
- There is still no master plan or national strategy for the development of SMEs in the country.

Access to information technology - electronic commerce

Electronic commerce has yet to be systematically developed in Vietnam. In the country as a whole there are only four Internet Service Providers (ISPs), and fewer than 100 companies with their own registered websites. The Internet is still a luxury to most people, with high service charges (2 US cents for each minute on-line) and extremely limited banking infrastructure support for e-commerce.

As in many other countries e-commerce could play a vital role in Vietnam in the future. Currently however, especially in rural areas, lack of proper telecommunications, hardware and software, training, human skills and access to appropriate technology constitute major obstacles to the development of e-commerce especially for SMEs. Today only 72,000 Internet connections are registered in Vietnam. Major effort is required by the government to improve the current situation.

4.2.3 Availability of Information

One of the first steps in entering the export business is to get adequate and reliable information on market opportunities. This is a major difficulty for many SMEs. Most obtain information through the media or by personal contacts and not through formal channels. These personal contacts could be relatives or friends living overseas, or acquaintances made at trade fairs, conferences or on private trips. Only the more dynamic SMEs tend to contact formal organisations like the SME Club, the Chamber of Commerce and Industry and the various Trade Associations for such information. However, the average SME can neither digest nor effectively use the large quantity of statistical data and general information from the above sources, even if they manage to obtain it. The lack of reliable and useful market information often leads to a situation where local firms export their products with lower prices than the competition or miss out on good business opportunities.

[19] Central Institute for Economic Management, 1998.

The availability of specific information regarding new technology has been improved with the opening of technology centres such as the Technology Presentation House (TPH) in Ho Chi Minh City. These centres have been established with the aim of introducing new technologies and advanced products - both local and international - that can be implemented in Vietnam.

4.2.4 Human capital - Skills and Qualifications

The skills of employees in SMEs do not meet desirable standards according to the Vietnamese government, because the majority of them, especially in small businesses, have not received any training while their educational level is low. Only about 5 percent[20] of employees in the non-state sector have a university degree. The majority of the owners of non-state enterprises established in recent years have also not received any training, but they have a higher level of general education. Nevertheless, only 31.2 percent of the owners of non-state enterprises have a university or higher degree[21], and 51.8 percent of proprietors have a management qualification. The percentage in proprietorships that have no management qualifications is 70.5 percent and in limited liability companies 26.4 percent.

5. Government's role and support for SMEs

5.1 Background

Until the beginning of the 1980s in Vietnam there were only two significant institutional forms in the economy: state-owned enterprises (SOEs) and co-operatives. Private production and business units were allowed to operate but their scale and scope were negligible. Economic management during this period was based on the mechanisms of central planning. Enterprises did not have any autonomy in their production and business process since the government controlled and distributed resources and applied a monopoly policy on trade.

Economic reform started in 1986, but by 1988 inflation was increasing at an annual rate of 40 percent with a large current account deficit. The events of 1989 convinced the Vietnamese Government that it would get no further help from its previous benefactor, the Soviet Union. Starting in that year it therefore adopted a package of measures introducing strict structural reforms and macroeconomic stabilisation, in line with IMF orthodoxy (Reidel and Comer (1997), pp. 195-197). The "shock therapy" included the adoption of a policy of trade liberalisation and switching the economy to a market price mechanism that accelerated reform. The abolition of the majority of subsidies helped, and indeed forced, enterprises to operate within the market mechanism. The shift to a market focus was a key element in the policy of economic reform and contributed substantially to the development of the private sector in Vietnam. The policy of creating a market economy through the liberalisation of business activities relied on two factors: that market forces determine production and business decisions, and that the valid rights of enterprises are protected by the state (Woo (1997)). One of the essential components of economic reform is defined in the policy for multi-sectoral development that recognises the permanent existence

20 General Statistical Office, 1996, p.97.
21 General Statistical Office, 1996.

of a variety of forms of enterprise and provides for their equal treatment under the law.

5.2 *Government's long-term vision*

The draft Socio-Economic Development Strategy (SEDS) 2001 – 2010 of the Central Committee of the Communist Party of Vietnam (SEDS), emphasises accelerating industrialisation and modernisation of the country and creating a foundation for Vietnam to become an industrialised country by 2020. In order to accomplish these aims the SEDS emphasises the importance of SMEs and private enterprises. A flourishing private sector and a growing number of SMEs would: absorb new workers as well as labour made redundant by the ongoing reform of the SOEs; be a key engine of economic growth; contribute to export growth; and play a vital role in the modernisation and industrialisation of Vietnam. The role of the government in supporting the further development of the private sector and SMEs will be essential, and involve leveling the playing field between SOEs and private companies and enhancing the business environment by: simplifying the tax system; streamlining administrative procedures; reducing red-tape and corruption; restructuring the banking system; and strengthening existing or, when necessary, creating additional support institutions. Particular focus is required for the development of SMEs in the rural sector where non-agricultural jobs are scarce, underemployment is high, and poverty widespread.

5.3 *Achieving the long term vision*

Since the change to the Constitution in 1992, recognising the right of freedom of business and equality before the law for all sectors of economy, the government has taken steps to develop the private sector and SMEs. Most recently the SEDS, the PSPAP[22] and a *draft* Governmental Decree on SME Promotion Policies Structure provide details of Government plans for further action in this area. These plans focus upon the following areas: enhancing the legal environment for SMEs; strengthening existing and/or establishing new institutions; easier access to capital; trade promotion and export development of SME/private enterprises; and improving the image of the private sector. These are now discussed in turn.

5.3.1 *Enhancing the legal environment for SMEs*

Since 1986 important achievements have been made in adopting and elaborating legal measures and in creating the legal framework within which all types of enterprises can operate. Up to the end of 1996, 55 laws (codes, laws and acts), 64 decrees and 251 resolutions had been promulgated[23]. However, the soundness and validity of the fundamental reform legislation is in doubt. Significant problems are being caused by the proliferation of legal instruments, many contradictory, which are issued at every hierarchical level. This is due partly to a lack of experience in constructing the legal framework and partly because of the nature of the culture and social structure and the tensions within it. This results in an inability of the state to make any one entity

[22] Private Sector Promotion Action Plan (PSPAP) agreed between Vietnam and Japan in 1999. Also called the Miyazawa Plan.
[23] Malesky *et al.* ((1998), pp.10-15, 73-4) provide an excellent summary of the nature and significance of these legal provisions.

accountable. The effect of which is a proliferation of state agencies with overlapping responsibilities and opposing functions (Kornai (1990)).

Although the legal system is still not complete and has many imperfections, it has provided a level of protection higher than before that has helped the economy to operate on a legal basis. However, overall reforms have been slow and moderate and have often been accompanied by arbitrary new rules. A government agency (Central Institute for Economic Management (CIEM) (1998)) identified the following main shortcomings:

- Legal regulations are too complex, ambiguous and contradictory.
- The legal environment for different types of enterprises is different and creates unequal grounds for enterprises to be established and operated. Many policies give priority to enterprises based on their ownership without supporting measures being linked to the scale of enterprise (so small enterprises which are officially or semi-officially owned receive more protection than larger ones which are not);
- Frequent changes in the regulations provide an unstable legal environment;
- Legal instruments are usually issued hastily, without corresponding support from supporting legislation;
- Some legal documents still lack a rational basis that causes difficulties and restrictions for enterprises, and creates gaps which they can abuse;
- Communication of the nature and implications of legal changes is still limited, and generally enterprises, especially SMEs, have limited knowledge of the regulations.

To advance the development of SMEs Vietnam requires a rule-of-law-based regulatory framework. The current system of vague and frequently changing regulations and excessive bureaucracy has resulted in: increased risk and cost of doing business; a drain on the resources and time of private entrepreneurs that would otherwise be available for investment or for management of the business; and has created an inhospitable business environment. Evidence from other countries shows that bureaucratic stranglehold, exercised through bureaucratic discretion, has been a major drag on private sector dynamism. To establish the rule of law as the basis for government-business relationships there will also be a need for institution-building.

A transparent legal and regulatory framework for the private sector, therefore, needs to be established, to ensure a level playing field for both SOEs and the private sector. Three actions over the medium-term will be required to achieve this. First, Government should continue to monitor carefully and implement effectively the Enterprise Law (e.g. eliminating, modifying and rationalising the remaining business licenses in other sectors) and the Domestic Investment law, since they are the key instruments for facilitating Vietnamese private entry further. In January 2000 the new Enterprise Law came into effect[24], permitting for the first time non-discretionary registration of private firms, instead of by Government approval, thereby eliminating bureaucratic steps. It also regulates the approval of establishment of a new business, which has to be decided within 15 days of the submission of the application. While this is a very important development, its implementation and enforcement is not yet consistent. Even though the Government has abolished many licensing requirements a

[24] Resulting in the establishment/registration of more than 10,000 new enterprises during 2000.

large number of licenses still need to be obtained, depending on the field of business. The momentum for the elimination of unnecessary licenses needs to be maintained.

The Government has announced its intention to promulgate a Decree on SME Promotion Policies Structure in order to demonstrate a commitment to SME promotion and its strategy for achieving this. This will provide guidelines on support measures for private enterprises and SMEs covering areas such as encouragement policies and the set-up of support institutions. The Decree, originally planned to be promulgated in 2000, requires promulgation as soon as possible. The government also recognises the need to encourage the establishment of new SMEs, and to this end make administrative procedures simpler and more transparent. The problem concerning bureaucracy and complicated procedures in holding back the development of SMEs is acknowledged in the SEDS[25].

Second, the revised Foreign Investment Law and Decision 24 need to be implemented in the spirit in which they were developed. Foreign investors should be encouraged, not discouraged, from engaging in joint-ventures with private Vietnamese firms, to facilitate transfer of technology, and enhance marketing contacts and management expertise. Third, there is a need to make the regulatory framework for private participation in infrastructure more transparent and predictable over the medium-term and conclude some of the build-operate-transfer (BOT) transactions in the power sector in the short-term. More generally, as recommended in the SEDS, implementation of equal terms for all enterprises regardless of ownership should be carried out as soon as possible in all relevant fields, e.g. related to bidding for Government procurement, access to land and credit etc.

In addition, it will be important to improve the situation concerning land use rights: Unclear and cumbersome procedures make it very difficult for private SMEs to acquire land. This presents a major obstacle since access to land use rights is essential, especially to private enterprises, as collateral for accessing credit. In order to improve access to land the following steps are necessary: i) clarify and speed up procedures for land title allocation; ii) unify and modernise registers for land and buildings; iii) reduce heavy fees and taxes on registration; iv) provide clear, simple and fair procedures for resolving disputes.

5.3.2 Strengthening of existing and/or establishment of new relevant institutions and changing social and administrative attitudes

Ministries and agencies involved in industry, planning, education and training, such as the Ministry of Industry, Ministry of Planning and Investment, and universities, are still geared towards support of the SOEs. These organisations will be required to should shift their focus towards the private sector and SMEs in order to enhance the general economic environment. This will require a fundamental change in social and administrative attitudes and a focusing upon an improvement in the image of the private sector in the country. The vital role of private companies for employment generation and modernisation of Vietnam should be acknowledged and disseminated through the media and the educational system at all levels. Given the many years of discrimination against private enterprises and private entrepreneurs, stronger and

[25] Central Committee of the Communist Party "Socio-Economic Development Strategy 2001-2010" (draft) p. 30.

more frequent endorsement of private business by the Vietnamese leadership is required as was the case in China. Regular public exhortations by top leaders of the Party and Government to the bureaucracy to provide support to private enterprises under the law, would be extremely helpful. Stories in the media of domestic private business successes and visits by top leaders to successful private exporters would help to reinforce the value of private business in Vietnam's development.

Apart from access to capital most SME entrepreneurs consider lack of access to technical and market information, lack of skilled labour and know-how as their main business obstacles. The government needs to implement measures that will strengthen the business environment for SMEs through enhancing the performance of existing organisations and/or establishing relevant new organisations where appropriate. Measures agreed upon but still not implemented include the establishment of a national SME Agency that will co-ordinate consistent SME development. At the national level a Council for Private Sector Promotion has been proposed to provide a forum for a regular dialogue between relevant parties such as Government agencies, local authorities, business organisations/associations and representatives of the private sector and SMEs. It will also provide advice on private sector and SME encouragement policies and programs.

Given the importance of mechanical engineering for the industrialisation and modernisation of Vietnam as well as the enhancement of technical know-how of entrepreneurs, the Government decided to establish three Technical Assistance Centres (TACs) (in North, Central and South Vietnam). The TACs not only concentrate on the enhancement of technical know-how but also support industrial sub-sectors such as textiles, ceramics, rubber/plastics, food processing and craft products, by providing engineering experts with experience in specific areas required by SMEs.

Providing an information system containing data on the latest developments for private enterprises through an Information Centre for Private Enterprises would benefit private enterprises. At the provincial and local level the authorities should be encouraged to incorporate the private sector and SME promotion into their local development plans. In addition appropriate institutions on the provincial and local level should be established or strengthened in order to support private business activities.

Measures that include a strengthened provision of Business Development Services (BDS) to assist the private sector and SMEs improve their access to resources, markets, new technologies, qualified labour would be beneficial. International experience shows that a growing number of private companies are the most flexible and effective providers of BDS to the diverse and fast changing demands of the private sector. A number of public organisations, including business associations, already exist in Vietnam providing these services and they should be part of the future support to the BDS market as well. Since many SMEs are not aware of the existence of, and benefits from, BDS and/or are unable to pay market rates, the development of a well functioning BDS market needs to be supported by the Government and/or local authorities.

In many countries business associations are playing a crucial role in identifying and advocating the needs and demands of the business community and in establishing a policy dialogue between the business community and relevant authorities. This has been acknowledged by the New Enterprise Law, which regulates, and the draft Decree on SME Promotion Policies Structure, which supports, the establishment and operation of private business associations.

5.3.3 Easier access to capital

A major constraint facing private SMEs in Vietnam is a shortage of funds. Private SMEs lack access to long-term loans, an equity financing system, and access to collateral. The strict collateral requirement by banks and the low incentives for State Owned Commercial Banks (SOCBs) to lend to SMEs, and on the other hand the unwillingness of private SMEs to deal with SOCBs, are serious constraints. This generates a vicious circle that prevents many SMEs from entering the formal credit sector, and forces them to rely on informal credit. Financial policies have an important impact on capital mobilisation and development of enterprises. Vietnam's banking reforms aim to address the shortages and problems of availability of credit and capital for the economy. However, the impact of these reforms on the domestic private sector will continue to remain limited if the private sector continues to experience difficulties in securing access to land use rights, their potentially most valuable source of collateral.

The Private Sector Promotion Action Plan (PSPAP), the so called Miyazawa Plan, agreed between Japan and Vietnam in 1999, includes more than 40 measures to diminish the constraints faced upon the growth of the private sector. It is based on three common principles: defining Government policy to promote the private sector; securing equal treatment for private enterprises vis-à-vis SOEs; and granting private enterprises freedom to conduct business within the laws of Vietnam. A number of these include measures to improve the financial environment of SMEs. Some of these have already been implemented such as: the promulgation of the Decree on the Lending Guarantee; the Circular related to the Auction System; the Decree Liberalising Transactions involving Land Use Rights in 1999; and the establishment of the Stock Exchange Centre in 2000.

Others key steps to achieve further improvement in the financial environment for SMEs are the creation of a Two-step Loan Fund and a Credit Guarantee Fund. An agreement for a Two-step Loan Fund was signed between the Japan Bank for International Co-operation (JBIC) and the Government of Vietnam in 1999. It intends to provide long-term credit to SMEs through selected participating financial institutions (PFI), including joint stock commercial banks. It is expected that 70 percent of the beneficiaries from this fund will be private SMEs. The Credit Guarantee Fund for SMEs aims to further encourage financial institutions to lend to SMEs by absorbing a part of the credit risk, thereby alleviating current borrowing constraints as a result of their insufficient collateral capacity.

Other measures proposed include further improvement of the regulatory framework on lending, mortgaging, and leasing, and the pending banking sector reform will also provide SMEs with better access to credit.

5.3.4 Trade promotion and export development of SMEs/private enterprises

The government has applied a relaxed policy on restricting imports and exports and, as a result, the growth in the value of exports and imports from 1992 has increased rapidly. During the period 1992-1999 the value of exports and imports has increased more than four times. However, the number of trade licenses given to enterprises in the private sector only accounts for 15-20 percent of the total number of trade licenses (Figures from Ministry of Trade, 1998). A number of general trade restrictions remain. Non-state enterprises are allowed to export commodities produced by them and can import the input factors necessary to their production. However, they have to get permission from the Prime Minister if they want to participate in other export and import activities. At the beginning of 1997 regulations limiting licences on exported commodities were abandoned. In addition, access to domestic and international markets for some valuable trade items is severely restricted. Licences to trade in rice, petroleum, fertiliser, black cement, cars, and motorcycles are only given to a few favoured enterprises. Only 19 enterprises are allowed to export rice and 25 enterprises are allowed to import fertiliser. Abandoning these regulations would greatly increase trading opportunities.

In addition to requiring export or import licenses, the Ministry of Trade still has the right to require specific additional licenses related to certain groups of exported or imported commodities. Furthermore, for some commodities additional export or import licenses must be obtained from the line ministries. The tariff system also remains extremely complicated with many tariff lines, and nominal rates are high and the range of tariff rates is excessively wide. The system of tariff codes is not compatible with the system of product codes.

While trade procedures have gradually improved a number of problems remain. Institutional support for trade is still not available. Effective measures to prevent a large inflow of smuggled goods are not available. Some policy measures, such as the 90/CP or 91/CP decrees, which established the state-owned general corporations, and the special preferential treatment to SOEs though the credit and trade policies, are disadvantaging SMEs in the private sector.

More recently, the promulgation of three new implementing Decrees related to the New Enterprise Law in 2000, and the removal of some quantitative restrictions in import management, represent a significant step forward in improving the trade and business environment for private sector development and SME support in Vietnam. Export licensing and trade management by quota is becoming less important than in the past. However some of the quotas now accessible to private enterprises need to be further opened up, and the bidding system should be more transparent. Also, special attention should be directed at the proper implementation of the new decrees, regulations and instructions of the Government.

At present, the major obstacle preventing SMEs from seizing trade opportunities is their limited experience of global trade. Fragmentary knowledge and understanding of foreign markets are some of the basic trade barriers. This applies not only for information about management accounting, technical requirements, marketing skills, import regulations and consumer preferences, but also for assessing the suitability of imported goods. Limited language skills of the entrepreneurs are also a problem. Lack of these fundamental skills could be a severe problem when Vietnam further integrates into the global economy in the coming years.

Overcoming these difficulties requires not only an extended exposure of Vietnamese entrepreneurs to the world market, but also an intensive teaching and training of SMEs. Tapping into the expertise existing in neighbouring and other foreign countries would be particularly beneficial.

Beyond the information gap, the low level of competitiveness and the restricted ability to produce larger numbers of identical items of similar quality and on time are other severe trade barriers for local SMEs. Therefore, tailor-made quality management systems have to be propagated and implemented in order to enhance SMEs export opportunities.

5.3.5 Image of the private sector

The image of the private sector has to be improved in the country. The vital role of private companies for employment generation and modernisation of Vietnam should be acknowledged and disseminated through the media and the educational system at all levels. Negative social and administrative attitudes towards private enterprises impact adversely upon behaviour towards those engaged in private activities. They influence individual's decisions to enter the private sector and, once entered, constrain their ability to unleash their full potential. Growing one's business and increasing its visibility through success is seen as a risky proposition by many entrepreneurs in Vietnam, because private business has tended to be viewed negatively.

With greater freedom for the private sector also comes the need for improved corporate governance. There are at least three problems of corporate governance that will need to be addressed if the private sector is to grow in a transparent, accountable and effective manner. First, a key characteristic of the private SMEs is that their organisations are quite opaque. Not only is the ownership-structure of most of these SMEs not known but also the way decisions are made is unclear. This is not much of a problem when firms are small, but as they become bigger and owner-managers' span of control is less adequate, absence of appropriate decision-making processes will constrain their growth. Second, most SMEs now do not maintain sufficient accounts or make any public disclosure of their accounts. Various types of restrictions and insufficient social acceptance of business success leads SMEs to misreport financial and other flows, when reporting is required. In the coming decade, it will be necessary to put in place the framework that will ensure that such enterprises act in a transparent and accountable manner.

6. Implementing an effective Competition Policy

From the earlier sections of this paper it is apparent that if Vietnam is to move forward to become a more market-oriented economy, the implementation of an effective competition policy is essential. There are a number of key ingredients. Firstly there is a need for ongoing ownership reform, and the generation of growth of new private enterprises. This requires a removal of barriers to new business so that entry into markets for all forms of ownership is free. In this regard encouragement to the growth of SMEs in industry, agriculture and transport, and especially in services where the greatest deficiency previously existed. This adds to economic activity, greater competition and efficiency in existing markets, and the development of new products and markets. Ownership reform can be seen as an evolutionary process in which the state and private sectors exist permanently side by side. The relative size of the private sector steadily increasing through time due to: the entry of new private firms; through the sale of certain state property rights at fair prices: and through the liquidation of inefficient state owned enterprises that prove to be unviable. All these three processes should be encouraged but not forced, allowing scope for experimentation and trials of various forms of ownership reform.

Secondly, encouragement should be given to foreign capital investment in the country. This not only alleviates the acute shortage of capital but also paves the way for attaining new technologies, adopting modern management methods, enhancing the skills of domestic workers, and gaining access to foreign markets. Foreign capital should not be encouraged to go into certain markets and not into others. Traditionally in Vietnam foreign capital was encouraged to go into import substituting sectors, were more capital intensive and their production aimed at satisfying domestic demand. As a result such investment did not focus upon those sectors of the economy where the country's comparative advantage lies, that is in the production of export oriented labour intensive manufactured goods. Restrictions on foreign sector investment, therefore, should be eliminated.

Thirdly, unviable state owned enterprises should be allowed to exit the market, and their resources put to more efficient and productive uses elsewhere in the economy. This will require exit mechanisms such as the introduction of bankruptcy and liquidation procedures. This is also an important component in the process of ownership reform, requiring greater involvement by the private sector in their ownership and management including in the form of privatisation (equitisation). Remaining state owned enterprises should be subject to hard budget constraints.

Finally, a level playing field in terms of access to markets and fair competition between the various forms of ownership needs to be created. Public ownership should not be forced out where it is capable of standing up to market competition, while there should be no discrimination against private ownership. The state as a buyer should not make public procurement decisions based on the form of ownership of the seller, instead purchases should be made on the basis of which seller offers the best price and conditions.

7. Summary and conclusions

Ongoing reform in Vietnam will require the revitalisation and equitisation (privatisation) of the country's many unprofitable SOEs, the development of a robust and dynamic private sector, as well as a further opening of the economy to foreign investment, competition, and trade. This reform, in the short term, runs the danger of increased unemployment and rising poverty, and potential social unrest that the authorities would wish to avoid. Such instability could be avoided if reform proceeds slowly, but would likely contribute to a stagnating economy that would fall further behind its already reforming regional neighbours. Hence the authorities face difficult choices. This paper has argued that the role of SMEs, particularly in the private sector, have the potential to play a crucial role in the future development of the economy by:

harnessing latent entrepreneurial zeal; creating new jobs for those made unemployed by a restructuring of state enterprises, and for those living in the countryside; bringing about a more efficient allocation of resources in line with the country's comparative advantage; expanding exports; bringing about a more equitable distribution of income; alleviating poverty in the rural sector; and promoting regional development. To date their contribution to the economy remains below what it could be, as demonstrated by the experiences of its regional neighbours. Hence greater emphasis needs to be placed upon their development.

A World Bank report observed that allowing farmers greater freedom of decision-making after the introduction of Doi Moi in 1986 made possible the agricultural growth that was "the main engine for Vietnam's first great wave of growth" (World Bank, 1998, p.30). It recommended that "unshackling SMEs from existing restrictions could unleash a second round of growth by boosting labour-intensive manufactures and processed agricultural exports, thereby protecting rural areas from the current slowdown" (*ibid*.). To date, however, private SMEs (that is registered private firms, have, according to the Bank, "played a minor role in industrial production, contributing only two percent of industrial output and have grown very slowly. Household enterprises play a much larger role" (*ibid*.).

The most cost-effective way of generating non-agricultural employment in Vietnam, according to a World Bank Consultative Group, is through promoting SMEs, that is registered private companies with between 50 and 300 employees (World Bank, 1998, p.29). Each job generated in an SME is estimated to require a capital investment of about US$800, compared with an investment of US$18,000 in a State Owned Enterprise (SOE) (*op.cit*. pp. 29-30). This conforms, says the Bank, to empirical evidence from other countries indicating that SMEs are more efficient users of capital under most conditions.

In line with this evidence the Government has stated that it will support the development of SMEs through favourable policies and assistance in finance, market information and staff training (specified in a draft strategy to develop SMEs in Vietnam to 2010 prepared by the MPI). To support SMEs, the Vietnam Chamber of Commerce and Industry is working with relevant agencies, including the MPI, on the establishment of a credit guarantee system. It is clear that further government support is needed to help SMEs develop. It will be necessary to offer additional tax incentives, and support in funds and floor space to develop production, as well as to devise reasonable financial policies to attract money from the public and encourage effective investment by the private sector. Priority for enterprises will need to be given to trade categories focused upon traditional trades, handicraft, consumer goods, exports and hi-tech products. In addition, the State needs to reform the way it manages SMEs, so that procedures can be simplified and made easier to implement. SME development in the rural sector to expand employment and reduce poverty should also be given priority.

If the changes in policy identified in this chapter address the four key areas of: enhancing the legal environment for SMEs; strengthening existing and developing new institutions; enable easier access to finance; trade promotion and export development; and improving the image of, and attitudes to, the private sector as well as its corporate governance, then the optimistic growth of the private sector outlined in the SEDS can be achieved. In addition, the implementation of a competition policy that focuses upon ownership reform and the elimination of market barriers to entry, encourages foreign investment, enables the closure of unviable enterprises, and puts all forms of ownership on an equal basis, will be an essential pre-requisite for the growth of the private sector and a return to high and sustainable growth. As China, another transition economy, has demonstrated, private firms, if given the right environment, can grow rapidly, from 100,000 to 1 million in number in just 6 years and make a major contribution to the economy. In the case of China, however, there is clear commitment from the government to bring about this structural transformation, while for Vietnam there is still the perception that the authorities are dragging their feet.

Despite the capital-intensive nature of much of Vietnam's growth, there have been encouraging signs in the last few years of the emergence of a labour-intensive export sector. Changes in trade policies have been an essential component of the doi moi policy adopted since 1986. Licensed private companies are now allowed to engage directly in international trade, breaking the trade monopoly of a small number of state owned enterprises operating under central or provincial authorities. However, until very recently, private enterprises had to satisfy a number of fairly restrictive conditions to obtain the necessary licenses. The recent removal of trade licensing, allowing companies to freely engage in trade within the registered scope of their business activities, should further improve the environment for export oriented industries. In addition, over the years, most export quotas have been lifted and export taxes have been reduced to generally very low levels. These reforms, together with sound macroeconomic management, have allowed Vietnam to exploit its comparative advantage in labour intensive manufactures, putting the country on track for export led growth. This is a major lesson to be learned from the rapid growth of its regional neighbours.

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