

Approaches to Support the Development of an Enabling Environment for Small Enterprises

Country report: Viet Nam

Draft Report prepared by Raymond Mallon, GTZ Consultant, mallon@netnam.org.vn
with support from the GTZ/VCA Project for the Promotion of Small and Medium Enterprises,
sme-promotion@sme-gtz.org.vn

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LIST OF ACRONYMS

ADB	Asian Development Bank
AFTA	ASEAN Free Trade Area
ASEAN	Association of South East Asian Nations
AusAID	Australian Agency for International Development
BDS	Business Development Services
CAS	Country Assistance Strategy
CDF	Comprehensive Development Framework
CEG	Capacity Building for Effective Governance (AusAID funded facility)
CG	Consultative Group
CIDA	Canadian International Development Agency
CIEM	Central Institute for Economic Management
CPRGS	Comprehensive Poverty Reduction and Growth Strategy
CPV	Communist Party of Vietnam
DFID	Department for International Development
FAO	Food and Agriculture Organization of the United Nations
FES	Friedrich-Ebert-Foundation
EC	European Commission
FDI	Foreign direct investment
GDP	Gross Domestic Product
GoV	Government of Viet Nam
GSO	General Statistics Office
GTZ	German Technical Cooperation Agency
HEPR	Hunger Eradication and Poverty Reduction
IFC	International Finance Corporation
ILO	International Labor Organization
IMF	International Monetary Fund
JBIC	Japan Bank for International Cooperation
JICA	Japan International Cooperation Agency
MDG	Millennium Development Goal
MFI	Multilateral Financing Institutions
MPDF	Mekong Project Development Facility
MPI	Ministry of Planning and Investment
NGOs	Non-Government Organizations
ODA	Official Development Assistance
OECD	Organization for Economic Cooperation and Development
PAR	Public Administration Reform
PG-SME	Partnership Group for SME Promotion and Private Sector Development
PIP	Public Investment Plan
PMU	Project Management Unit
PRGF	Poverty Reduction and Growth Facility
PRSC	Poverty Reduction Support Credit
PRSP	Poverty Reduction Strategy Paper
SBV	State Bank of Vietnam
SIDA	Swedish International Development Cooperation Agency
SME	Small and medium enterprise
SMED	SME Department (within MPI)
SNV	Netherlands technical cooperation organization
SOE	State owned enterprise
SWAP	Sector-wide approach
TA	Technical assistance
UN	United Nations
UNDP	United Nations Development Program
UNIDO	United Nations Industrial Development Organization
VCCI	Viet Nam Chamber of Commerce and Industry
VND	Viet Nam Dong
WB	World Bank
WG	Working Group (on the enabling environment for SMEs)
WTO	World Trade Organization
ZDH	German confederation of craft associations

EXECUTIVE SUMMARY

1. The Committee of Donor Agencies for Small Enterprise established a working group on the enabling environment for SMEs in 2000 to review donor experiences in supporting efforts to improve the policy environment for small enterprises in selected countries. Countries selected (and lead agency in brackets) for initial case studies were: the Balkans (WB), Caribbean (DFID), Peru (ILO), Tanzania (Netherlands), and Viet Nam (GTZ). Summary findings from these case studies are to be presented to a Donor Committee meeting to take place in Turin, Italy from 16-20 September 2002. This report describes outlines the experience in Viet Nam, describing the country context for reform, the key stakeholders involved, recent donor experiences, emerging trends, and lessons learned.
2. This review is also timely for Vietnamese institutions and donors because of the recent enactment of the SME decree, and the decision to establish a new SME Department (SMED) in MPI. These developments have led to increasing donor interest in supporting SME and the private sector development.

Country Context for Small Enterprise Development

3. Viet Nam is a low income country in transition to a market economy. Human development indicators are relatively high, given per capita income, but market institutions in Viet Nam remain under developed. Until the mid 1980s, the State actively discouraged private business activity. Most private enterprises and cooperatives in Viet Nam are SMEs, as are about 70 per cent of all State enterprises.
4. Viet Nam has been remarkably successful in the transition to a market economy with relatively strong growth and economic stability for most of the 1990s. From a closed economy, the ratios of FDI and exports to GDP have increased rapidly to levels that are high by international standards. Poverty incidence has fallen from more than 70 per cent in the mid-1980s to about 37 per cent in 1998. Most employment growth has been generated in the informal and private sectors.
5. Success has been achieved despite major institutional weaknesses and a policy bias against the private sector. More recently substantive changes have been introduced to address these weaknesses, including the approval of a new Enterprise Law, a SME decree, simplification of business licensing, easing of restrictions on private involvement in export trade, providing domestic and foreign investors with similar incentives, relaxation of registration and minimal capital requirements, and amendments to the 1992 Constitution to recognize the long-term role of the private sector. The result has been a rapid acceleration in new business registrations.
6. The Government issued a SME decree in November 2001 allowing SMEs to *enjoy preferential treatment policies*". Early this year, the status of the private sector was enhanced when a Party Plenum resolved that the private sector is "*an integral part of the national economy*". Stronger official endorsement of the private sector embodied in recent policy changes has helped build investor confidence.

Domestic Stakeholders in the Enabling Environment

7. Characteristics of the Vietnamese reform process include: (i) most public policy decisions are only made after broad consensus is reached on policy directions; (ii) many formal changes business regulations are just formalizing what is already happening in practice in parts of the country, and; (iii) national policy makers rarely rely directly on external advisors in policy formulation.

8. Viet Nam is governed by the Communist Party of Viet Nam (the Party). The Party Secretary-General, Prime Minister, President, and National Assembly Chairperson are members of the Party Politburo (the 19 member leadership committee). Most senior government officials and National Assembly members also belong to the Party. Party support is crucial in securing major formal changes in policies and regulations affecting business. Some Government and Party officials have family and friends engaged in business and are personally aware of their constraints. This has facilitated State dialogue with business.

9. Formally, Viet Nam has a unitary system of government. In practice, provincial administrations exercise some autonomy. There is considerable variability in the sub-national (provinces, districts, and commune level) application of national policies and regulations and this can have a major impact on the local business environment. Within Government, the Central Institute for Economic Management (CIEM) has led efforts to improve the enabling environment. The Prime Minister's Advisory Group and the Institute for Economic Research have also been active in pushing for reforms. Ultimate legislative authority rests with the National Assembly, which is increasingly involved in addressing constraints to business development.

10. As private businesses grew, managers have had to deal with an increasing number of officials from outside established networks to secure administrative decisions. Business people began to see benefits in working with each other, the Party, government officials, and the media, to push for change. The Viet Nam Chamber of Commerce and Industry (VCCI) has been the most active business association in promoting improvements in the enabling environment.

Donor Experiences in Viet Nam

11. When the MFIs resumed normal operations in 1993, major reforms had been implemented, substantive macroeconomic stability had been achieved, and there had been a clear acceleration in growth in economic output, employment, trade and investment. The Government has actively sought to study international experiences, and obtain comments from international experts on the reform process since early in the *Doi Moi* period. Limited donor support on enabling environment issues during the early period of reform was mainly financed mainly by SIDA and UNDP.

12. However, policy dialogue was constrained during the early period of reform because association within foreigners -- especially those from Western countries -- was controlled. Language problems further restricted any informal dialogue. Viet Nam's success in opening its economy has also meant that it is less dependent on ODA for external financing. This has meant that, despite sharp increases in ODA inflows since the mid-1990s, donors have had less financial leverage to push reforms than in more ODA dependent economies.

13. Donor support to the enabling environment has included assistance directed at: (i) providing a stable macroeconomic and institutional environment; (ii) improving the policy and regulatory environment directly related to SME development; and (iii) strengthening institutions and policy implementation to promote SME development.

14. Modalities of donor support have included: (i) joint donor dialogue with the government on enabling environment issues; (ii) direct support to new policies and regulations; (iii) institutional capacity building, and (iv) policy based lending. Most discussants felt that there was a role for all modalities, but perceptions on policy lending varied. Most agreed that, because of the strong national ownership of reform, policy lending was only effective when it was supporting reform measures for which there was already a broad national support.

15. Tangible direct outputs of donor support to the enabling environment included (i) increased awareness of the potential benefits of small enterprises in increasing employment and incomes, reducing poverty, and promoting balanced debate; (ii) stronger capacity to analyze issues related to business development; and (iii) increased awareness of international approaches to improving the enabling environment for business development.

16. While there are some effective partnerships between some donors, formal coordination arrangements and partnerships in the area of SME and private sector development are weak. The SME Promotion and private sector development partnership group meets infrequently and does not have a single national counterpart. However, the NGO led SME Forum is meeting informally most months. With the rapidly increasing donor interest in supporting SME and private sector development -- and concerns about national capacity to absorb increased donor support for SME development -- improvements in coordination mechanisms are needed.

Further Developing the Enabling Environment

17. Despite recent progress, much remains to be done. Consultations on business issues are still done on an *ad hoc* basis. Recent reforms have not been consistently implemented in all sectors and provinces. The legal basis for establishing business associations is still to be finalized. Progress is often (at least partially) undermined by administrative inertia, or new decisions and circulars. National institutions responsible for ensuring compliance with business regulations remain weak. While this may suggest a need for additional donor assistance, it must also be recognized that much has been achieved with limited donor assistance. Strong arguments would be required to justify any substantive increase in support to the enabling environment.

18. Donor interest in supporting improvements in the enabling environment for small enterprise development in Viet Nam has increased substantially in recent years with a substantial pipeline of new projects at various stages on formulation. It is important to recognize that the absorptive capacity of institutions directly targeting SMEs is limited. When planning support for SMEs, it is useful to recognize that many of the improvements in the enabling environment that are likely to have the biggest pay-offs for SMEs are not necessarily classified as SME projects.

Conclusions and Lessons Learned

19. Strong national ownership of the reform process has been crucial to successful implementation. Without a strong national commitment to increase employment, incomes, and living standards through business development, donor support is unlikely to have been as successful as it has been in Viet Nam. Thus, experiences from Viet Nam may not be applicable to countries that lack this commitment.
20. Donors can influence the policy agenda. In some cases, donor support has facilitated, and very likely improved, the formulation and implementation of Government initiated measures to improve the enabling environment (e.g., the Enterprise Law). In other cases, donor support has resulted in the issuance of new policy documents (CPRGS) or regulations (the SME decree) that -- while consistent with Government policy -- are unlikely to have been issued in that form without donor support.
21. Formulating donor assistance. National ownership and demand for donor support to reforms is crucial for assistance to be effective. This cannot be assured if projects are designed primarily by external consultants visiting Viet Nam for a few weeks. Extensive dialogue between counterpart and donor agencies is required to clarify needs and the potential role of TA in addressing these needs. A realistic assessment of the national context for policy reform is needed to ensure that assistance addresses national needs.
22. Opportunities to improve the enabling environment often emerge unexpectedly. Projects need to be designed to react to emerging opportunities. A strong professional relationship between the counterpart and donor agency can help in providing flexibility in responding to changing needs.
23. Donors do not need to finance “SME projects” to support improvements in the enabling environment for small enterprises. Reform elements that are likely to have a major impact on small enterprises development include: (i) public administration and regulatory reform; (ii) land policy and administration systems (iii) taxation; (iv) access to information; (v) financial services; (vi) contract enforcement; (vii) business associations and improved advocacy support; (viii) increased local involvement in planning infrastructure and services.
24. Project organization and timing issues. Building capacity to address reform issues is more likely to be successful when support activities are integrated into the counterpart agency. Projects established outside existing structures can lead to difficulties in accessing counterpart staff, limit informal contact between international staff and key counterparts, restrict access to policy makers, delay decision-making, and limit potential gains from institutional strengthening.
25. Strong counterparts are in short supply, are often swamped with donor support, and face difficulties in supplying adequate counterpart staff. Donors need to look for opportunities to support weaker institutions, especially at the local level where many of the remaining problems facing small enterprises are now encountered. In sensitive reform areas, high level counterparts may prefer support from donor agencies perceived as “neutral” or less ideological in the provision of advice.

26. While donors may feel confident about what an ideal enabling environment should include, the process of realizing this improvement is always much more complex and much more time consuming than donors usually expect.

27. Building support for reform. Donors need to work with business, media, legislators and industry organisations to build support for reform. Analysis of the distributional impacts of the reforms has often been weak. Assisting domestic agencies to publicize policy studies, draft legislation, and related documentation, to undertake comparative studies and to conduct well-structured workshops can help build support. Arguments that reforms will increase employment, reduce poverty, and ensure more equitable income distribution are more effective in building support for reform in Viet Nam than focusing on the need for reform to promote private sector development.

28. Use of consultants. The consultant mix is a critical issue. Long-term experts are expensive and may be underutilized, but can help develop the informal relations with counterparts needed to improve understanding domestic issues and priorities. Greater use of domestic consultants can be cost-effective, strengthen domestic capacity, and build a domestic constituency for reform.

29. Government officials noted considerable variability in the effectiveness of consultants. In addition to sound technical skills, inter-personal and communication skills are also crucial in supporting reform processes.

30. International expertise can sometimes be tapped more cost-effectively using information technology. International consultants can comment on study designs, draft reports, and draft regulations by internet. Considerable comparative information can be downloaded from the Web.

31. Training and workshops. Donor support has contributed to tangible improvements in skills levels within national agencies over the last decade. But, there is also perception that too many donor funded study tours and workshops are not particularly effective because they are poorly planned or not taken seriously. Getting value about of study tours requires careful planning and selection of trainees.

32. The common practice of paying *per diems* to attend training has a strong adverse selection bias. Those with minimal work commitments, and limited opportunity cost for their time, may attend training just to get the *per diems*. Paying people to attend can reduce the incentive for trainers to deliver quality training. Vietnamese have demonstrated a willingness to pay for quality training through the high levels of attendance at private after hours training courses. The rapid increase in privately financed and provided short-term vocational training services suggests that caution is needed in analyzing whether donor support is needed for such training.

1. INTRODUCTION

Background to study

33. The Committee of Donor Agencies for Small Enterprise (the Committee) was established in 1979 to: (i) exchange information; (ii) share experience and lessons learnt; (iii) coordinate efforts, and; (iv) establish common best practice guidelines. The initial focus was on micro-finance and business development services.

34. In 2000, the Committee established a working group (WG) on the enabling environment for small and medium enterprises (SME), chaired by the Netherlands Government. In March 2002, the WG agreed to review recent donor experiences in supporting government efforts to improve the policy environment for small enterprises in selected countries. The aim of the survey is to contribute to:

- improved understanding of similarities and differences in agencies' efforts to help countries improve the policy environment for small enterprise development;
- an overall stock-taking of the content, processes and outcomes of member efforts, by assessing specific country experiences; and
- deriving principles of good practice that could help guide future collaboration at the country level.

35. The WG agreed to initially survey five countries. Countries selected (and lead agency in brackets) were: the Balkans (WB), Caribbean (DFID), Peru (ILO), Tanzania (Netherlands), and Viet Nam (GTZ). Two consultants were recruited to draft a consolidated report for submission by the WG to the Committee at a meeting in Turin, Italy from 16-20 September 2002. This Viet Nam country report was prepared by a GTZ consultant, funded under a GTZ Headquarters research and development project, with substantive assistance from a GTZ project supporting SME development in Viet Nam. Business, government and donor agencies assisted by responding to surveys, through interviews and workshop comments, and by providing evaluation reports.

36. This review is also timely for Vietnamese institutions and donors because of the recent enactment of the SME decree, and the decision to establish a new SME Department (SMED) in MPI. These developments have led to increasing donor interest in supporting SME and the private sector development. The study also aims to provide information that may be useful to donor planning new assistance, and also lay the foundations for increasing information sharing and coordination of donor support to the enabling environment.

Terminology

37. The WG defines the “enabling environment” or “policy environment” as the policies, laws and regulations that affect small enterprise operations. This includes both small enterprise specific, and overall economic, policies. The study terms of reference excludes donor assistance for business development services or financial services. Policy activities affecting small enterprises considered in this study include:

- Aspects of the business environment that are relevant for the development and growth of the development of a vibrant private sector, such as a stable macro-economy and an effective legal framework;
- Aspects of the business environment that may have a specific impact on small and medium enterprises (including household enterprises);
- The government's approach to SME policies and institutions, and specific SME promotion policies.

38. The WG has decided that study should “*only aim at interventions that have had an intended and explicit focus on and policies for, and those affecting, small enterprises. The review should address processes where donors have been involved in support interventions at either the national, provincial or local level. This includes past interventions that are now completed (over the last two to three years), current interventions, and planned interventions*”. With regard to the term small enterprises, “*The Committee considers this term to include formal and informal non-agricultural enterprises ranging from micro to medium size.*”¹

39. The Government defines SMEs as: “*those independent business and production establishments that have registered their business under the current legislation, have the registered capital of less than VND 10 billion or the average number of annual employees of less than 300*”². Virtually all of the 70,000 private enterprises formally registered at the end to 2001 were SMEs, as were all the informal enterprises and cooperatives. About 70 per cent of the approximately 5,600 State enterprises are also SMEs. For all practical purposes, the domestic private sector is a subset of SMEs in Viet Nam. The focus of this study is on private formal and informal non-agricultural enterprises ranging from micro to medium size.

Study methodology and timing

40. The study objectives were presented to a launch workshop in May 2002 attended by representatives of donor agencies. Discussion at this workshop helped identify priority issues to be included in the Vietnamese study. Major donors and Government agencies provided summary written information on key initiatives to support the development of enabling environment for small enterprise development. Follow-up individual discussions helped in developing understanding of approaches and best practices. This draft will be circulated to members of the partnership group and other key agencies to seek their comments on this report before finalization. The draft study report was prepared in May/June 2002.

¹ See www.sedonors.org.

² Decree 90/2001/CP-NDD, 23 November 2001.

Structure of report

41. The following section briefly describes the country context. This is followed by a brief review of the key stakeholders involved in improving the enabling environment, then a section reviewing donor experiences and outcomes of donor support, and a section describing emerging trends and needs for support. The final section summarizes the major study conclusions and lessons learned.

2. COUNTRY CONTEXT FOR SMALL ENTERPRISE DEVELOPMENT

Introduction

42. The aim in this chapter is to provide a brief introduction to the context within which enterprise development is taking place in Viet Nam. Such an introduction is important because past attempts to develop a centrally planned economy means that the institutional base for private enterprise development in Viet Nam is quite different to other market economies. Secondly, a review of the reform process illustrates the strong national ownership of the reform process which has important implications for the way donors can support -- but not force -- improvements in the enabling environment for small enterprises.

Transition to a market economy

43. Viet Nam is a low income country in transition, from a centrally planned economy, to a market-oriented economy. Human development indicators are relatively high, given per capita income, but many of the institutions that underpin an efficient and competitive market economy are relatively newly established and poorly developed. Most entrepreneurs operating in Viet Nam have less than one decade of experience in business. And up until the mid 1980s, the State and supporting institutions actively discouraged businesses activity and encouraged society to view private business as detrimental to the best interests of society³. While Government decisions paving the way for household business were issued as early as October 1986⁴, legislation governing private enterprises and companies and private enterprise were only issued in 1990. The Constitution was amended in 1992 to recognize officially the role of the private sector.

44. The policy shift to a more market oriented economy (“*Doi Moi*”) was announced at the 6th Party Congress in November 1986. This change in policy direction was in response to a mounting economic crisis, with hyperinflation and stagnating growth. A National Assembly approved a Land Law in 1987, and the Party passed a resolution giving farmers medium term rights to use land for agriculture purposes in 1988. These land reforms, devaluation of the exchange rate, and the relaxation of controls on prices and domestic trade helped accelerate agriculture sector growth rates. Subsequently, individuals were given long-term rights to use land for residential purposes. Industrial and domestic trade policy reforms provided the basis for a rapid ex-

³ Former Prime Minister Pham Van Dong noted in 1993 that the stigmatism attached to traders under Confucianism, and to business activity under Communism, “is not easily undone overnight”. (See Tuong Lai, 1999, *The Role of Small and Medium Scale Business in the Renovation Process of Vietnam*, p. 5.

⁴ Council of Ministers Decisions 169, 170 and 171, 14 November 1986, “Renovation of the Management of State Farms”, “Policy Directions Towards the Private Economy and Private Business Enterprises in Agriculture, Forestry and Fisheries”, and “Reorganization and Renovation of Management in Agricultural Cooperatives”, and Council of Ministers Decision 146, 26 November 1986, “Development of the Family Economy”.

pansion in household enterprise activity. These reforms laid the foundations for the emergence of new entrepreneurs and the accumulation of private capital⁵.

45. Increased economic stability, dramatic reductions in barriers to external trade and foreign investment, and improvements in private and State enterprise incentive structures contributed to strong economic performance through most of the 1990s. This growth was mainly driven by increased household activity, export growth and a surge in foreign direct investment (FDI) inflows up until the mid-1990s. Official Development Assistance (ODA) inflows also increased sharply during the mid-1990s. Formal domestic private businesses played a minor role in total economic output and growth during this period. FDI approvals peaked in 1996 as it became increasingly clear that approvals to build new hotels, offices, and other property development far exceeded demand. With the onset of the Asian economic crisis in 1997, and the rapid devaluation of the currencies of major regional competitors, Viet Nam faced a downturn from its previously strong export growth. FDI inflows also fell drastically from 1997. Following its onset, some Vietnamese observers warned that the Asian crisis illustrated the dangers of globalization⁶. Others emphasized the need for renewed efforts to mobilize domestic investment resources. The later argument appears to have been persuasive, as major improvements in the enabling environment for domestic private enterprise have been introduced since 1997.

46. Viet Nam has been remarkably successful in the process of transition to a market economy, with relatively strong growth and macroeconomic stability for most of the 1990s. From a closed economy, the ratios of FDI and exports to GDP have increased rapidly to levels that are high by international standards. Viet Nam has signed bilateral trade agreements with many OECD members, is a member of AFTA, and is seeking WTO membership. This has all helped Viet Nam to diversify economic cooperation and minimize dependence on ODA.

47. Most importantly, the reforms have led to sharp reductions in poverty. Poverty incidence fell from more than 70 per cent in the mid-1980s, to about 37 per cent in 1998. The informal and private sectors have generated almost all the employment growth that has helped reduce poverty. State employment actually declined during most of the early reform period. The impact of growth in informal and private sector employment on poverty reduction has probably been a telling factor in reducing ideological barriers to private sector development. Recent policy reforms in China also appear to have influenced Vietnamese decision makers.

⁵ These reforms also helped Viet Nam to adjust to the cutback in external assistance from, and trade with, the former USSR in 1988/89.

⁶ Viet Nam was particularly vulnerable to an economic downturn in Asia, because about two-thirds its exports went to Asia, and a similar level of FDI approved was from Asia also accounted for about two-thirds of FDI approvals. However, the eventual impact of the crisis on Viet Nam was less than expected. Economic growth fell to about 5.8 per cent in 1988 and 4.8 per cent in 1999, before recovering to more than 6 per cent in 2001.

Emergence of Private Enterprises in Viet Nam

Introduction

48. Before the introduction of *Doi Moi*, private business was repressed and mostly limited to household businesses, often with uncertain legal status, and operating mainly in the black economy. The reform process had a strong spontaneous element, with newly emerging entrepreneurs taking the initiative ahead of policy changes. Consequently, there has been considerable uncertainty about what was legal during the reform process⁷. Many informal traders and small-scale private business were operating by the end of the 1980s, albeit mostly without official approval. The number of household businesses increased from about 0.84 million in 1990 to 2.2 million by 1996. Following approval of the Company Law in 1990 the numbers of private companies increased steadily, with 190 joint-stock companies, 8,900 limited liability companies, and 21,000 private enterprises registered by 1996. While the SME sector remained small, the foundations for future progress were being laid. A recently published SIDA financed study of entrepreneurship between 1991 and 1997 concluded that:

*“Generally speaking small-scale enterprises in Vietnam were considerably larger and more robust in the 1997 survey than they had been six years earlier. Income, capital and assets have all grown..... Furthermore, higher levels of value added per worker unveil growth not only in size, but also in efficiency. The increases in labor productivity are universal and in many instances remarkable.”*⁸

49. Informal actions and institutions played a key role in that rapid expansion of household and micro business in Viet Nam during the early *Doi Moi* period⁹, and have underpinned much of the recent employment growth in Viet Nam. However, as firms grow the limitations of informal institutions include:

- the need to deal with “outsiders” such as foreign bankers and traders increases as the scale of business grows, -- either party may doubt that informal mechanisms will result in transparent and equitable outcomes.
- opportunities to enter contracts depend on established relationships based on past business contacts. Thus, informal institutions have a bias against new entrants with negative consequences for equity and efficiency.
- the formal financial sector often requires formal contractual arrangements to reduce transaction costs, and risks, in assessing and enforcing debt repayment.
- informal arrangements can breakdown in periods of general financial stress. Borrowers continue to operate loss-making businesses longer than they should,

⁷ de Vylder, S and Fforde, A. 1988. *Vietnam: An Economy in Transition*, SIDA, Stockholm, p. 62.

⁸ Per Ronnas and Bhargavi Ramamurthy (Eds), 2001, *Entrepreneurship in Vietnam: Transformation and Dynamics*, p. 327.

⁹ This is not unique to Viet Nam. Most transactions are conducted with limited reliance on formal contracts and enforcement mechanisms in many market economies, especially in Asia. Instead, parties to a contract rely on relationships to enforce or adjust commitments, and/or to address non-performance of commitments. Penalties for non-performance are linked to reputation and opportunities to engage in future business. See Mallon. (1999), “Experiences in the Region and Private Sector Incentives in Vietnam”.

losses increase, and financial difficulties can spread to suppliers and creditors. Such difficulties have been seen recently in East Asia

50. These limitations are particularly pronounced in Viet Nam because business networks -- and informal “rules of the game” -- that played a pivotal role in financing private investment elsewhere in East Asia, are less developed in Vietnam¹⁰.

The Asian financial crisis and enterprise development

51. As the Asian crisis spread, the 4th Party Plenum (December 1997) agreed on a resolution calling for broader enterprise reform and for a more consistent regulatory framework for all types of business entities in order to generate increased investment and employment. The Party announced initiatives to: (i) amend the law on domestic investment; (ii) develop an Enterprise Law applicable to different business entities; (iii) streamline procedures for business registration, residence permits, and travel documents to facilitate business development and employment generation; (iv) clarify regulations on the inspection and monitoring of enterprises; (v) distinguish between civil and criminal breaches of the law; (vi) develop policies conducive to healthy competition and; (vii) establish institutions to resolve commercial disputes¹¹.

52. Considerable progress was made in most of these areas in subsequent years. Key changes, and donor support for these changes, are summarized in Appendix 1. Despite recent improvements in the enabling environment, the share of the domestic non-State sector in industrial output in Viet Nam declined from 24.6 to 22.4 percent of the total, as output from foreign invested industrial enterprises grew at faster than the domestic private sector (see Table 1).

53. This more robust Party commitment to the domestic private sector was soon reflected in national policies, most notably in the 1999 Enterprise Law. Other major changes included the liberalization of restrictions on private and small enterprises engaging in export trade, amendments to the law on domestic investment to provide the domestic private investors with more of the incentives provided to foreign investors, relaxation of business registration procedures and minimal capital requirements, amendments to the 1992 Constitution to recognize the long-term role of the private sector, and changes in processes of consultation with the business investors and society in addressing barriers to private investment.

Table 1 : Share of Industry Group Output by Ownership

Industry Group	1995				2000			
	Total	State	Domestic non-State	Foreign Investor	Total	State	Domestic non-State	Foreign Investor

¹⁰ Mallon, R. (1999), “Experiences in the Region and Private Sector Incentives in Vietnam”.

¹¹ Seven months later, the 5th Party Plenum (July 1998) highlighted the need to improve domestic resource mobilization to better utilize the large amounts of untapped capital still “under the mattresses”.

TOTAL	100.0	50.3	24.6	25.1	100.0	42.0	22.4	35.5
<u>1. Mining</u>	<u>13.5</u>	<u>2.3</u>	<u>0.7</u>	<u>10.5</u>	<u>13.6</u>	<u>1.8</u>	<u>0.5</u>	<u>11.2</u>
Coal	1.6	1.6	0.0	0.0	1.2	1.1	0.0	0.0
Oil and gas	10.5	0.0	0.0	10.5	11.2	0.0	0.0	11.2
Metal ores	0.2	0.2	0.0	0.0	0.1	0.1	0.0	0.0
Stone and others	1.1	0.5	0.6	0.0	1.1	0.6	0.5	0.0
<u>2. Manufacturing</u>	<u>80.5</u>	<u>42.0</u>	<u>23.0</u>	<u>14.6</u>	<u>80.5</u>	<u>34.3</u>	<u>21.9</u>	<u>24.3</u>
Food and beverages	26.1	12.5	8.7	5.0	20.2	9.3	6.6	4.2
Tobacco products	3.9	3.8	0.0	0.0	2.9	2.9	0.0	0.0
Textile products	6.0	3.4	1.5	1.0	4.8	2.6	1.3	1.0
Garments	2.9	1.0	1.3	0.5	3.1	1.0	1.4	0.7
Leather tanning and processing	3.4	1.3	0.9	1.2	4.6	1.4	1.2	2.0
Wood and wood products	3.2	0.7	2.2	0.3	1.9	0.4	1.3	0.2
Paper and paper products	1.9	1.1	0.5	0.3	2.1	1.1	0.8	0.2
Publish, print, copy recorded materials	1.5	1.4	0.1	0.0	1.1	1.0	0.1	0.0
Coke and refined petroleum products	0.3	0.0	0.0	0.3	0.1	0.0	0.1	0.0
Chemicals	4.9	3.7	0.5	0.7	6.1	3.8	0.7	1.6
Rubber and plastics	2.2	1.0	0.9	0.3	3.5	1.1	1.6	0.8
Non-ferrous metals	8.9	6.0	2.5	0.4	8.9	5.2	2.0	1.7
Metal production	3.3	2.0	0.3	1.0	3.0	1.3	0.4	1.3
Metals products	2.3	0.4	1.6	0.3	3.2	0.5	1.8	0.9
Machinery and equipment	1.3	0.9	0.3	0.1	1.2	0.7	0.2	0.3
Computer and office equipment	0.0	0.0	0.0	0.0	2.6	0.0	0.0	2.6
Electrical machinery and apparatus	1.1	0.8	0.1	0.2	1.9	0.9	0.3	0.7
Radio, TV & communications equipment	2.0	1.0	0.1	0.9	2.4	0.4	0.0	2.0
Medical and precision instruments	0.2	0.0	0.1	0.0	0.2	0.0	0.0	0.2
Assembly & repair of motor vehicles	1.4	0.2	0.2	1.0	1.1	0.2	0.2	0.8
Produce/repair other transport equipment	1.8	0.7	0.4	0.8	3.6	0.5	0.4	2.7
Furniture	1.9	0.2	1.6	0.1	2.1	0.1	1.5	0.5
Recycling	0.1	0.0	0.1	0.0	0.1	0.0	0.1	0.0
<u>3. Electricity, Gas and Water Supply</u>	<u>5.99</u>	<u>6.0</u>	<u>0.0</u>	<u>0.0</u>	<u>6.0</u>	<u>6.0</u>	<u>0.01</u>	<u>0.0</u>
Production, distribution of electricity & gas	5.27	5.3	0.0	0.0	5.4	5.4	0.0	0.0
Supply, purification & distribution of water	0.73	0.7	0.0	0.0	0.5	0.5	0.0	0.0

Source: Derived from GSO, 1997 and 2001, Statistical Yearbooks.

Enterprise Law: Impacts on small enterprise development

54. Drafting of the new Enterprise Law was a crucial turning point in Government relations with the domestic private sector, with protracted and substantive consultations with the business community, the media, and members of the National Assembly. This has helped in building confidence that the Government and Party are committed to private sector development, changing attitudes of society and officials, and in building the broad community support for reform and private sector development that has been so important in implementing change¹². While the thrust of earlier business legislation was that private enterprises might be permitted if they complied with Government controls, the Enterprise Law codified mechanisms to protect the rights of citizens to establish and operate private businesses. It also establishes the right of investors to be protected from undue interference from government or other officials, provided businesses operate legally.

¹² Difficulties in implementing many regulations and laws in Viet Nam often reflect problems in building consensus for change. State enterprise and public administration reforms have been particularly difficult to implement.

55. Subsequently, the Government revoked about 150 business licenses and permits, and simplified licensing procedures. This reduced establishment and operational costs, and reduced opportunities for corruption. The time required to register a business fell from an average of about 90 days to 7 days, and the fees paid to consulting firms for registering a company fell from about VND 10,000,000 to VND 500,000¹³. Simplified procedures have reduced opportunities and incentives for corruption, reduced uncertainty about the legality of business operations, and allowed investors to focus their efforts on business development.

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

57. This streamlining of procedures and costs contributed to a rapid acceleration in the registration of new business, including many businesses that previously operated in the “grey” economy. During the first year of enactment, 14,444 enterprises were newly registered under the Enterprise Law, about 2.5 times the number of registrations in 1999 under earlier legislation. By the end of 2001, some 35,000 enterprises had been newly registered under the Enterprise Law. Some of these enterprises were already operating informally, but most were newly established¹⁴.

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

Promoting SME development

59. While some donors focused on removing barriers to private sector development and on other moving to a level playing field for all enterprises, other donors (notably UNIDO/Germany, Japan, ILO and a number of NGOs) were working closely with the Government to formulate policies and develop institutions to support SME development. With support from these agencies, the Government issued a SME decree in November 2001¹⁵ aimed at helping create employment¹⁶ through policies ensuring

¹³ Steering Group for Enterprise Law Implementation estimates. Actual costs vary for different types of enterprises.

¹⁴ In its presentation to the mid-term CG meeting (May 2002), the WB estimated that 70% were newly established.

¹⁵ Decree 90/2001/CP-NDD, 23 November 2001, and Decision 139/2001/QD-TTg, 20 December 2001.

that “SMEs shall enjoy preferential treatment policies”. SMEs are defined as “independent production and business establishments, which make business registration according to the current law provisions, each with registered capital not exceeding VND 10 billion or annual labor not exceeding 300 people”.¹⁷ All enterprises registered under the Enterprise Law, state enterprises (SOEs), cooperatives and registered household business¹⁸ that have up no more than VND 10 billion in capital or no more than 300 employees are considered SMEs.

60. The Decree provides for a specialized SME Department (SMED) to be established within MPI to: (i) develop policies and legal documents on SME promotion and review the impact of support programs; (ii) organize training for personnel in SME support organizations; (iii) coordinate donor support for SME promotion; (iv) coordinate efforts to provide information for SMEs; (v) coordinate the provision of technical and management support to SMEs; (vi) report on SME development; and (vii) act as the standing secretariat of the SME Development Promotion Council.

61. An SME Development Promotion Council is to be established to advise the Prime Minister on policies and mechanisms to encourage SME development. The Council is to be chaired by the Minister of MPI with representation from central and local government agencies, business associations, and academics¹⁹. Council activities are to be funded through SMED.

62. SMED is to establish SME Technical Support Centers in Hanoi, Ho Chi Minh City and Da Nang to advise SMED on practical SME issues to provide direct consulting support on technical and management issues. SMEs are to be encouraged to join existing enterprise associations and to establish new associations. The various levels of Government are required to meet regularly with SMEs to help identify constraints and to develop reforms to address these constraints.

63. Recent regulatory developments have laid the foundations for targeted support for SME development, but the Director for SMED has not been appointed and little concrete action has been taken to implement this decree. Moreover, SMEs were not specifically referred to in the March 2002 Party Plenum, which called for greater efforts to ensure that all enterprises were treated equally by the Government. It is not clear how the Party’s call for equal treatment of enterprises will be reconciled with the SME Decree provision that SMEs shall be accorded “preferential treatment policies”.

¹⁶ Article 1 states in part that “*The State encourages and creates favourable conditions for SMEs to bring into play their activeness and creativeness, raise their managerial capability, develop sciences, technologies and human resources, expand their cooperative ties with enterprises of other forms and increase the business results as well as competitiveness on the market; develop production and business, create jobs and improve the life of workers.*”

¹⁷ The Decree also states that, in providing support to SMEs, these criteria may be applied flexibly.

¹⁸ Household business registered under Government’s Decree No.02/2000/ND-CP (3 February 2000).

¹⁹ Members include: (i) the Minister of MPI (Chair); (ii) Director of SMED (Standing Secretary); (iii) representatives from the Ministries of: Planning and Investment; Industry; Finance; Agriculture and Rural Development; Construction; Communications and Transport; Trade; Science, Technology and Environment; Education and Training; Labour, War Invalids and Social Affairs; and Justice; (iv) representatives of the People’s Committees of Hanoi, Ho Chi Minh City, Hai Phong and Da Nang; (v) representatives of VCCI; the Central Council of the Union of Vietnamese Cooperatives; and other enterprise associations, and; (vi) several economic, scientific, technological and training experts.

Other recent initiatives to improve the enabling environment

64. A string of initiatives have been introduced since approval of the Enterprise Law which have the potential to improve further the regulatory environment for small enterprises. Since February 2000, private enterprises have been allowed to convert, transfer, lease, provide as collateral and capital contribution to banks or to joint-ventures²⁰. The 9th Party Congress (March 2001) endorsed a Socio-Economic Development Strategy for 2001-2010 that included the strongest commitment yet to move towards a level playing field for all enterprises²¹. The Public Administration Reform Master Plan approved by the Prime Minister in September 2001 represents a potentially important step towards addressing remaining barriers to small enterprise development and leveling the playing field for all enterprises²².

65. The December 2001 meeting of the National Assembly amended the Constitution to provide clearer recognition of the long-term role for the private sector in the economy, and formally approved the Socio-Economic Development Strategy for 2001-2010.

66. The 5th Plenum of the 9th Party Congress (March 2002) stressed that the private sector is “*an integral part of the national economy*” and has played a crucial role in “*generating more jobs and procuring further for the State budget and making an important contribution to GDP growth.*” The Plenum endorsed measures to create an attractive business climate and a fair and competitive playing field for all enterprises and set priorities for further reform to support private section development, including: (i) further improving the Enterprise Law and reduce remaining barriers to the entry of new businesses; (ii) changing the land law and mortgage procedures to make it easier for the private sector to use land use rights as equity and/or collateral; (iii) facilitating lending to the private sector through the provision of guarantees and consulting services; (iv) changing the accounting system to encourage private enterprises to adopt professional accounting systems; more clearly distinguishing between civil and criminal violations of commercial regulations; (v) asking national leaders to promote the image of the private sector; and (vii) allowing business people to retain Party membership.

67. The recently approved Comprehensive Poverty Reduction and Growth Strategy (CPRGS, May 2002) emphasizes that SMEs “*play an important role in the nation’s economic growth, in creating employment and reducing poverty*”²³. The CPRGS stipulates the need to create a level enabling environment “*for all types of enterprises from all economic sectors*” and notes the important role of SMEs in promoting balanced economic growth.

²⁰ Decree 04/2000/ND-CP (11 February 2000).

²¹ There are also, however, continuing references to the State playing a leading role in economic development, not only as regulator but also in providing goods and services in strategic industries.

²² The Master Plan states that “*The administrative procedures, which are bureaucratic, cumbersome and troublesome to businesses and people, will be fundamentally abolished; new administrative procedures, which are of transparency, simplicity and convenience to people, will be developed.*”

²³ Government of Viet Nam (May 2002), “The Comprehensive Poverty Reduction Strategy”, p. 50.

68. The strong official endorsement of the private sector has been of great significance in building investor confidence. There is increasing confidence that the State will continue to be responsive in removing barriers to private business development. There is also increasing pressure on those mid-level officials that have been reluctant to adapt to the streamlined business procedures.

3. DOMESTIC STAKEHOLDERS IN THE ENABLING ENVIRONMENT

Introduction

69. The aim in this section is to review the role of major stakeholders and the pressures to improve the enabling environment for small enterprises -- and especially small private domestic enterprises -- during the last five years, including an assessment of the role of donors in this process. It is worth reiterating that the private sector development is effectively a subset of all Vietnamese SMEs. Nearly all private enterprises and cooperatives in Viet Nam are SMEs, as are 70 per cent of State enterprises. The Vietnamese domestic private sector is equivalent to the SME sector in most other countries. Most constraints facing the domestic private SMEs in Viet Nam is because they are private, rather than because of their size.

70. Frequent references to the private sector in this report partly reflects the fact that official statistics generally breakdown enterprise data by ownership (State, foreign, private, cooperative, or household) rather than by size. Indeed most national policy documents -- such as the Socio-Economic Development Strategy and Party Plenum resolutions -- focus reducing barriers to private sector development, rather than SME development. However, the Government's main report to donors at the mid-term CG meeting and the CPRGS, note that SME development is crucial to generating the employment needed to ensure sustainable reductions in poverty.

Review of reform processes in Viet Nam

71. Economic reforms in Viet Nam have been driven primarily by the need to create new employment opportunities in order to increase incomes and reduce poverty. Agriculture and the household sector presently provide the majority of employment in Viet Nam. Most of this is low income employment. Grass-roots pressure to improve economic opportunities and increase living standards has been important in driving the reform process. Periods of deteriorating external conditions have acted to increase pressure for change at both the grassroots and top level policy making. The credibility of the Government and the Party depend on continuing to improve living conditions. At the same time, the backing of Party and Government leaders has been important in removing formal institutional barriers to business development. Donor provided information on international experience on the role of SMEs in employment creation, and in developing domestic policy analysis capability, has also helped to increasing awareness of the potential benefits of SME friendly policies.

72. While much of the reform process remains opaque, several more visible features have an important bearing on donor attempts to support the enabling environment. Firstly, most public policy decisions are only made after broad consensus is reached on policy directions. Affecting major policy and institutional change requires sustained efforts in consensus building. This has to be a nationally led -- and often very time consuming -- process. Opportunities for external input are mostly limited to presentation of international experiences, and assistance in analyzing potential impacts of policy options.

73. Secondly, many of the formal regulatory changes affecting private business are in effect formalizing what is already happening in practice in some parts of the country. Other reform efforts were initially implemented on a pilot basis. In effect, “learning by doing” has been an important feature of reform efforts. For example, the private sector began to emerge and small-scale private trading was widespread before it was formally legalized. Land use rights were widely used for collateral for informal credit before this was allowed. More recently, domestic business associations are emerging while the draft decree on their operations is still being drafted. Many of the smaller SOEs have responded rapidly to changing market circumstance, but not always in accordance with State regulations on corporate governance. Indeed, SOE assets have at times been used for personal benefit. Where policy reforms have clearly been top-down (e.g., the Bankruptcy and State Enterprise laws, and equitization), implementation is often problematic.

74. Thirdly, national policy makers rarely rely directly on external advisors in policy formulation. Advisors need to work at maintaining the communications with Vietnamese partners to understand information needs. When needs are understood, advisors can help provide counterparts with information and international experiences that may help their partners to develop their arguments for policy improvements. External advisors can also help in developing capacity in policy analysis, and commenting on domestic studies, policy proposals, and draft regulations. At times changes promoted by donors and external advisors are adopted, but it is the process by which this policy change occurred is difficult to define or attribute. Few external advisors would claim to understand fully the policy-making process²⁴. It is often difficult to even know who the key players are in the policy making process.²⁵

The Party

75. Viet Nam is a one-party state, governed by the Communist Party of Viet Nam (the Party). Key policy directions are established at Party Congresses which are usually held every five years. The Central Committee of the Party meets 2-3 times a year to discuss particular policy or sector development issues. The Prime Minister, President, and State leaders are generally members of the Politburo of the Party (the 19 member leadership committee). Most senior government officials and most members of the National Assembly are also Party members. Most Ministers and many provincial leaders are members of the Central Committee of the Party.

76. Party policy formulation draws on the resources of Party institutions, Government agencies and national research institutes. Within the Party, the Economic Committee and the Ho Chi Minh Institute are directly involved in business development issues. The distinction between the Party and Government is often opaque, but the Party plays a key role in setting policy directions and strategic targets. The Party has an extensive network reaching to the grassroots.

²⁴ Indeed, national discussants noted difficulties in accurately describing the reality of national policy-making processes.

²⁵ All this suggests readers should be cautious about reading too much into the analysis in this report.

77. Party support is crucial in securing major formal changes in policies and regulations affecting business. The resolutions of the 4th Plenum of the 8th Party Congress (December 1997) mapped out the major business reforms introduced during the last few years. The resolutions of the 9th Party Congress (March 2001), and the 5th Plenum of the 9th Party Congress (March 2002) provide the direction for future reform of the enabling environment for business. Donor support to Party private sector policy formulation has been mostly indirect through projects with Government agencies, and via high level policy dialogue.

The Government

78. Formally, Viet Nam has a unitary system of government, with centralised state authority exercised over local administrations. In practice, provincial administrations exercise some autonomy. The Government is responsible for drafting and implementing business policy and regulations. The Government is increasingly required to consult with the key stakeholders in developing business related policies and regulations. At the central level, the Ministry of Planning and Investment (MPI) has a leading role in drafting most policies and regulations affecting business in Viet Nam. It is responsible for developing overall economic planning (annual and long-term), public investment planning, ODA coordination, enterprise registration, and SME policies. The Ministry of Trade has important role in terms of the Commercial Code and competition policy, and Ministry of Finance for taxation policy and regulations.

79. Within the central government, the Central Institute for Economic Management (CIEM) under MPI has been a leading proponent of economic reform in general and of business development in particular. CIEM continually argued that the development of market institutions and the removal of barriers to domestic business development were crucial to increasing national competitiveness, balanced economic development and accelerated poverty reduction. CIEM has worked closely with the Viet Nam Chamber of Commerce and Industry (VCCI) in securing change. Other individuals and organizations such as the Prime Minister's Research Commission (PMRC), and the Institute for Economic Research in Ho Chi Minh City have also been active pushing for improvements in the private sector enabling environment.

80. There are three sub-national levels of administration: provinces, districts, and communes. Each level of local administration has an executive arm (the People's Committee) and a representative arm (the People's Council). Most small enterprise interaction is with the sub-national administration. There is considerable variability in the sub-national application of national policies and regulations and this can have a major impact on the local business environment. Streamlining of sub-national administrative structures has a potentially important role to play in improving the enabling environment for small enterprises.

81. Most donor support to improve the enabling environment for business has been directed through the Government, and especially the central Government.

The National Assembly

82. Ultimate legislative authority rests with the National Assembly, and the assembly has in recent years taken on greater importance as a forum for debating national policies. The role played by the National Assembly should increase with the appointment of 125 paid full-time members amongst the 498 members.

83. The National Assembly has been increasingly vocal in raising business concerns about barriers to business development. It played an active role in reviewing and influencing the provisions Enterprise Law. Policy papers analyzing weaknesses of the old business legislation, reviewing provisions of business legislation, and proposing changes to legislation were circulated to members of the National Assembly for discussion even before drafts of the new Enterprise Law were submitted. With increasing public policy debate on business issues, the National Assembly is likely to become an increasingly important player in securing business reforms.

84. Sustaining improvements in the enabling environment will require efforts to develop the access of National Assembly members to policy analysis and legal drafting services. Donor support to the National Assembly has been recently increased from a low base. People's Councils (the equivalent of the National Assembly at the provincial level) have received minimal support from donors.

The judiciary

85. The role of the judiciary in business development has so far been minimal. Few business people make use of the courts to resolve commercial disputes. Cases that do go to court often face major delays in securing decisions, with frequent allegations of corruption. Enforcement of court decisions is also problematic. The demand for a professional and independent judiciary can be expected to increase, as the scale of business enterprises develops. There is also scope to help strengthen lower cost, non-judicial arbitration arrangements. Only limited donor support has been provided to strengthen this area of the enabling environment for business.

Domestic business and civil society

Interactions between business and the bureaucracy

86. While entrepreneurs emerged from a broad cross-section of society, contacts with the State apparatus are particularly valuable in periods of regulatory and institutional ambiguity. Many Government and Party officials have family and friends engaged in business. Thus, officials were often personally aware of the bureaucratic and administrative constraints faced by entrepreneurs. This has facilitated and encouraged recent moves to more formal consultations between the State and the business community to reduce barriers to business growth.

87. As business has developed, managers have had to deal with an increasing number of officials from outside established networks in order to secure licenses, pay taxes, secure financing, receive quality certification, etc. Business people became more aware of the administrative barriers to enterprise development. This, and an increasing

number of entrepreneurs without access to decision makers, has helped create demand for more transparent rules of the game. Business people began to see benefits in working with other business people, the Party, government officials, and the media, to push for change. Increased demand for change coincided with more systematic consultation between the State and the business sector to address business constraints.

Domestic business associations

88. One visible indicator of the growing role of civil society is the large increase in numbers of business associations established in recent years²⁶. The growing number of business associations provides a potentially important vehicle for increased donor support to improving the enabling environment for business, and in holding government agencies more accountable to small enterprises.

89. VCCI has been the dominant business association in recent efforts to improve the enabling environment for business. VCCI differs from its counterparts in most market economies in terms of its close relations with the Government. Most VCCI staff have worked with the Government, many senior staff are members of the Party²⁷, and the Government financed much of the VCCI infrastructure. Moreover, it has a large number of SOEs as members. Some external observers argue that VCCI is constrained in criticizing the State, because of the close links with the Party and the Government. Some domestic business people argue that VCCI is especially effective in presenting business constraints to the Government because of its very close links with the senior leadership of the Government and the Party. VCCI has played a visibly proactive role in pushing for the reforms embodied in the Enterprise Law and related business regulation reforms. VCCI works with the Government in organizing regular dialogue with the domestic private sector, including an annual high level dialogue attended by the Prime Minister.

90. Two other active associations with broad cross-sector mandates are the Union of Associations of Industry and Commerce and the Young Business Associations. The Young Business Association has become increasingly active in pushing for the removal of barriers to new entrants. There are also growing numbers of sector or issues based business associations.

91. A number of NGOs (including international business associations, the Asia Foundation and the German Central Association of Chambers of Crafts (ZDH)), Germany, ILO, UNDP and UNIDO have supported VCCI activities in recent years. VCCI is also a major partner of the twice yearly Business Forum that is organized by IFC to coincide with the Consultative Group meetings.

The domestic media

92. Public dissemination of information about the employment and equity implications of administrative and regulatory constraints to private sector development by

²⁶ MPDF and Asia Foundation, 2002, Business Associations in Viet Nam: Status, Roles and Performance

²⁷ The current President of VCCI was a former Deputy Prime Minister and former Party Central Committee member.

organizations such as CIEM and VCCI helped to increase public awareness of the issues, and helped to build support for reform. With a gradual easing of media controls, the media has begun playing a more active role in national dialogue on business constraints. The media now reports on the advantages that small private domestic investments are having in terms of increased employment, distributional and equity impacts, compared with the more capital intensive investments typically made by SOEs and foreign investors. There is also increasing reports on the adverse impacts of unnecessary and poorly drafted regulations in facilitating corruption, and in stifling investment and employment growth. Increased media reporting on business issues reflects growing concerns by the public and senior leadership of the Government and Party about administrative barriers to business development.

93. Opportunities for donors to work directly with the business media are probably quite limited. However, with the quality of public policy debate in the press improving, more can be done to ensure that key donors financed studies and reports are accessible to the media.

Universities and academic research institutes

94. Government (CIEM) and Party (Ho Chi Minh Political Institute) research institutes have been more active than universities and academic research institutes in improving the enabling environment for business. However, academic institutes are increasingly involved in research on issues impacting on the enabling environment for business. Leading individual academics are involved in national policy debate, sometimes at very high levels. More frequent and substantive critical studies are being undertaken and published that address barriers to business development. And the results of such studies are more frequently reaching the public media. The Viet Nam Economics Association is directly involved in business publishing²⁸. The Viet Nam Union of Science and Technology is an umbrella group of professional associations is also actively engaged in the policy debate on reform issues. Donor supported projects at research and academic institutes help to improve the enabling environment for business by improving capacity for semi-independent policy analysis of business issues, increasing domestic consulting capacity, and developing capacity to train those who will be responsible for implementing the improved enabling environment.

²⁸ The Viet Nam Economics Association publishes business magazines and has a consulting business.

4. DONOR EXPERIENCES IN VIET NAM

Introduction

Overview

95. As noted earlier, the opaque and highly consensus oriented nature of the policy making process in Viet Nam means that it is difficult to accurately assess donor contributions to improving the enabling environment for business. The main aim of this section is to provide an overall perspective and to describe selected donor experiences in order to draw out some of the lessons learnt to date. More substantive analysis would be required to provide a detailed evaluation of the impact of donors' contribution to recent improvements in the enabling environment for small enterprises.

Role of donors in overall reform process

96. Most major reforms towards a market economy were taken when external assistance was modest. During the late 1980s and early 1990s, aid flows from the former USSR ceased and Viet Nam had to rely on the limited assistance provided by UN agencies, Sweden, Finland, and Australia²⁹. Viet Nam was not subject to major aid conditionality. When the multilateral financial institutions (MFIs) resumed normal operations in 1993, major reforms had been implemented, substantive macroeconomic stability had been achieved, and there was accelerating growth in economic output, employment, trade and investment. Pressures that led to these reforms were largely internal, albeit often accentuated by deteriorating external circumstances.

97. However, the Government did actively seek to study international experiences, and sought comments from international experts on the reform process early in the *Doi Moi* period. This support was financed mainly by SIDA and UNDP, but the multilateral financing institutions (MFIs) also provided advisory support. This helped in exposing policy makers to international experiences and best practices.

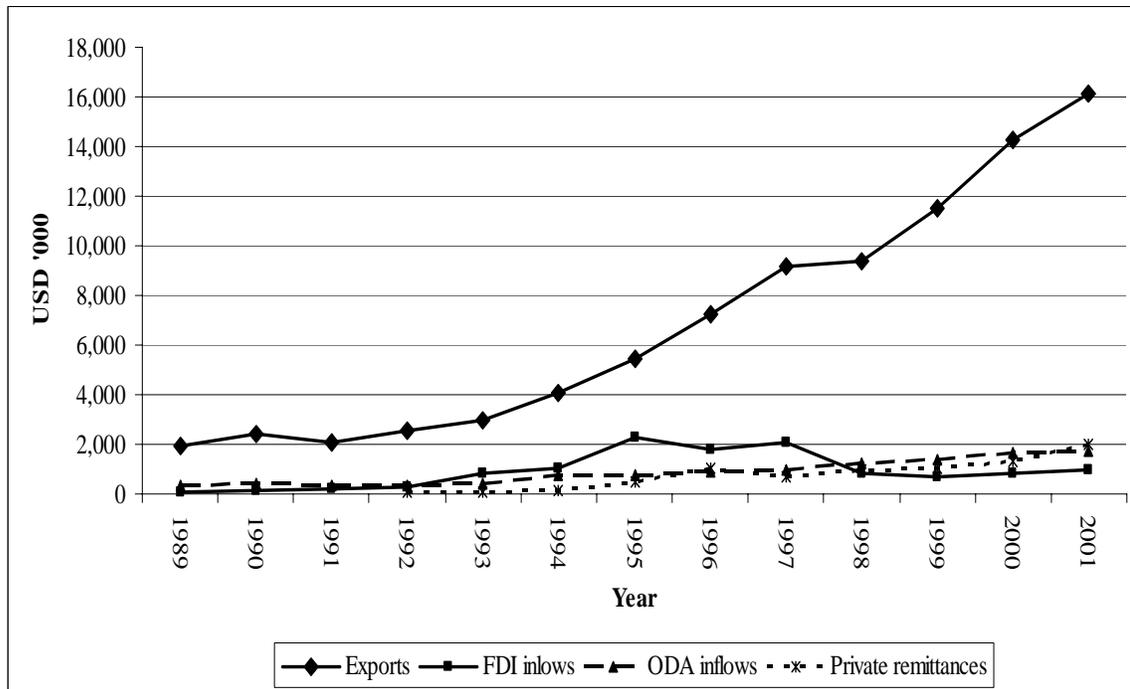
98. While the Government actively sought inputs from external sources during this period, policy dialogue was constrained during the early period of reform because association within foreigners, especially those from Western countries, was closely controlled. Until recently, donor interaction with officials from Vietnamese institutions was largely restricted to formal meetings. Language problems further restricted any informal dialogue. Despite more relaxed attitudes in recent years, attempts to understand the reform processes remain a major challenge for most. Donge, White & Nghia (1999) argued that:

“In summary, formal policy dialogue has played little role in economic reform in Vietnam to date. However, the input of ideas has supported policy change and allowed it to be moved forward, and this is precisely the sort of input which may be expected to be most successful in Vietnam given the way that the political system works.”

²⁹ Government of Viet Nam (1993), *Viet Nam: A Development Perspective, Government Report to the Donor Conference*, September 1993.

99. As noted earlier, the ratios of FDI and exports to GDP have increased rapidly to levels that are high by international standards. Viet Nam has also been successful in attracting increasing levels of inward remittances from overseas Vietnamese. Viet Nam's success in opening its economy has meant that it is less dependent on ODA for external financing. This has meant that donors have had less financial leverage to push reforms than in more ODA dependent economies.

Figure 1: Selected sources of foreign exchange inflows (1989-2001)



Focus areas of donor support to improve the enabling environment

Stable macroeconomic and institutional environment for business development

100. A stable macroeconomic and institutional environment for business development is an essential element of a favorable environment for business. IMF, World Bank and Japan have played leading roles in providing broad policy advice on macroeconomic stabilization. Sweden and Germany have also been provided support through CIEM, and UNDP through support to the Development Strategy Institute in long-term planning that has fed into the formulation of long-term plans. Other donors have supported formulation of sector and local development plans.

101. A broader range of donors have been involved in specific policy issues such as trade and taxation. Donors have also advised on the policy issues and drafting of competition policy and monopoly regulation. Indeed, support for the transition to a market economy as element of their strategy for Viet Nam has been a common theme of most donor strategies for providing support to Viet Nam.

102. Most major donors have institutional strengthening projects aimed at improving broader policy implementation. UNDP, Sweden and ADB have played a leading

role in supporting the public administration reform need for effective policy implementation. This support has contributed to the recent approval of master plan for public administration reform, which includes a focus on improving the enabling environment for business. ADB also provided technical support to MPI in conducting a study to help identify major barriers to enterprise development.

103. The EC has financed support to develop the accounting, auditing and insurance professions. UNDP has provided financial support to the development of consulting services. The USA and other donors have supported intellectual property right and copyright protection. Sweden, Denmark, Australia, UNDP and ADB have supported the development of legal services and institutions. Foreign commercial providers of such services have played a particularly important role in developing capacity in the provision of business services.

Policy and regulatory environment directly related to SME development

104. Improving the policy and regulatory environment for the domestic private sector and SMEs has been a constant theme in donor-Government dialogue on broad development issues through the Consultative Group and partnership mechanisms. The CPRGS developed with donor inputs includes extensive reference to the importance of private and SME development in employment growth and poverty reduction.

105. UNDP and GTZ provided substantial technical support in developing the Enterprise Law and the Law on Promotion of Domestic Investment through projects based at CIEM. UNDP (AusAID co-financing) also helped with the streamlining of business licenses and training and awareness raising activities aimed at facilitating implementation of the Enterprise Law and related regulatory reforms. Initial assistance was also provided to develop a national business registration system linking provincial business registration offices³⁰. GTZ still has ongoing assistance to CIEM, and UNDP has recently approved a follow-up program of support with CIEM to improve the regulatory environment for business. AusAID envisages further support to CIEM through its CEG facility.

106. Japan, GTZ, UNIDO and ILO provided direct support for the development of policies, regulations, and institutions related to the promotion of SMEs, including the enactment of the SME decree and the establishment of SME supporting institutions. Japan included enactment of the SME decree as conditions for release of balance of payments support. Now broad policies and institutional arrangements are in place, the above donors and the ADB are actively planning support to strengthen SME institutions. SME/Private Sector Development is a key pillar of German-Viet Nam economic cooperation.

107. The Asia Foundation, IFC/WB, UNDP/AusAID and UNIDO/Germany have supported dialogue between the Government and business to address business development with important implications for promoting SME development.

³⁰ Some provincial business registration offices were strengthened as part of public administration reform. In Ho Chi Minh City, private foreign partners helped develop the country's first computerized and on-line business registration systems.

108. Finally, foreign professional firms have also provided advice on the development of regulations impacting on SME development.

SME institutional and policy support to promote SME development

109. Now that decisions have been taken on broad policies and institutional arrangements for promoting SMEs, many donors are actively planning substantial additional institutional support to implement SME promotion policies.

110. There is growing interest in supporting the development of business associations. ZDH (Germany) provided support in drafting the decree on business associations and the Asia Foundation has supported dialogue related to the establishment of business associations. The Asia Foundation together with MPDF recently undertook a study on Business Associations in Viet Nam. Several donors have supported VCCI through projects and studies, including GTZ, ILO, MPDF, UNDP, and ZDH. Other donors (e.g. Canada and Denmark) have supported the establishment of business associations as part of sector and/or business development projects.

111. Donors supporting the provision of business development and financial services for SMEs include ADB, Canada, Denmark, EC, Germany, IFC (MPDF), ILO, Italy, Japan, Netherlands (SNV), Sweden, Switzerland, UNIDO, and the World Bank.

Modalities of donor support

Joint donor Government dialogue on enabling environment issues

112. The donors meet jointly with senior levels of the Government on a formal basis twice a year under the CG process to discuss broad socio-economic development issues. Approaches to improving the enabling environment sector for private sector development have been a frequent topic of discussion at these meetings. However, some discussants felt that this issue had received less attention in recent years than SOE reform and the enabling environment for foreign investment.

113. An IFC led Business Forum (formerly the private sector forum) convenes at the same time as the CG meetings to discuss business constraints and proposed solutions to address these constraints. While focus of business forum has primarily focused on foreign investment issues -- and some suggested most active participants in the forum represented western and Japanese foreign investors -- many of the constraints addressed by the forum were constraints to both foreign and domestic investors. Moreover, the processes used may have had spillover effects in terms of improving the direct dialogue between Government and the private sector.

114. Policy studies and joint workshops as inputs to the Socio-economic Development Strategy, the CPRGS, the public administration reform program, the legal needs assessment, and other planning processes have also provided useful opportunities for donors and Government to discuss options and to develop cooperation in improving the enabling environment.

Consultative Group (CG) Process and the Business Forum

Led by MPI and the WB, the CG process provides an ongoing mechanism for all major donors to discuss, publicly and jointly, priority development issues with the Government. The CG has one major meeting per year at the end of each year, plus a mid-term CG meeting to review progress on actions agreed at the annual CG meetings. Potential benefits to improving the enabling environment sector for private sector development, and priority actions to promote private sector development, have been a frequent topic of discussion at CG meetings.

An IFC led Business Forum is held in parallel with the CG meetings to discuss business constraints and proposed solutions to address these constraints. While foreign businesses issues have tended to dominate discussion, the business forum, together with the emphasis on private sector development at CG meetings, has probably helped raise the profile of private sector and small enterprise development in the public policy debate.

Direct support to new policies and regulations

115. Much of the donor support to improve the policy and regulatory environment directly related to SME development took this form. This included support for legislation on enterprises, cooperatives and domestic investment; business regulation, registration and licensing reform, and; the SME decree. The forms of assistance provided by donors to support new policies and regulations include:

- providing expert advice to comment and advice on policy issues and draft regulation,
- providing expert advice to assist in the design and conduct of Government initiated policy studies that feed into the formulation of new policies and regulation,
- provision of tailored training and/or workshops directly related to the particular policies or regulatory issues,
- tailored study tours to see how the particular policy and regulatory issues have been addressed in other countries,
- financing costs of consultative processes with stakeholders, and
- undertaking studies on policy and regulatory issues, sometimes with minimum direct input from domestic institutions.

UNIDO/German Support for the SME Decree and SME Department

The German financed UNIDO project “Assistance to Industrial SMEs in Viet Nam” contributed to improvements in the enabling environment by: (i) providing direct advice on the enabling environment; (ii) building capacity to analyse SME policy issues; and (iii) strengthening the capacity of private and public institutions to provide business services. The third component helped in building understanding of practical constraints, in testing approaches and in ensuring more relevant advice under the first two components. Participatory processes included stakeholder interviews with follow-up seminars to review findings and recommendations. A 1999 project research paper on SME development issues was widely circulated and discussed. These processes were seen as important building support for SMEs to be placed higher on the policy agenda and contributed to initial drafts of the SME decree.

UNIDO approved additional two years support from October 2000 to build on earlier progress towards providing a separate enabling environment for promoting SME development with UNDP and German financing. This assistance focussed on developing institutional arrangements for SMED in MPI and helped in defining technical assistance needs to support implementation of the SME decree. A final workshop planned for later this year aims to introduce SMED to donors and to help mobilize donor support for SME promotion activities.

Experience from this project suggests that donors need to provide assistance over a protracted period to help build trust and to develop support for change. Building consensus takes time. This support also demonstrates that donors can influence policy making through sustained policy support.

Institutional capacity building

116. Most donors include elements of institutional strengthening in the project design. The most prevalent forms of institutional building support include:

- general on-the-job training though working with international experts,
- training in policy processes by working with domestic counterparts and consultants to design and conduct of policy studies on issues related to private and small enterprise development,
- providing tailored training and/or workshops related to developing and implementing and improved enabling environment for business,
- specialized and post-graduate staff training,
- support to attend regional and international policy and research workshops and seminars,
- collaborative research projects between national and foreign researchers,
- tailored study tours to gain exposure to policy development and implementation processes in other countries,
- advisory support in reforming business practices, simplifying procedures, increasing transparency, and providing increased incentives for performance.

CIEM/UNDP Project to Improve the Regulatory Environment for Business

Project Characteristics

Process oriented with extensive use of consultative approaches to build support for regulatory reform. Domestic consultants had primary responsibility for undertaking policy studies. External consultants helped in study design and in commenting on study analysis and findings, commenting on draft policy and regulatory documents, and in providing an international comparative perspective.

Factors Contributing to Project Success

- *Extensive consultations during formulation facilitated by earlier support that provided experiences, developed relationships, and allowed in-depth assessment of Executing Agency (EA) needs and what external agencies and experts could deliver.*
- *Strong EA commitment to Project. EA saw benefits from earlier assistance and had a clear vision as to how the project could assist ongoing work. Motivated staff was a key factor.*
- *Project was driven by EA needs, and designed to support capacity to undertake the day-to-day activities of the EA. Thus, counterpart support was always available, and Project added minimum additional administrative burden on the EA.*
- *Training, including study tours, had very clear learning objectives and were well planned in advance.*
- *Flexibility in design, and EAs good working relations with funding agency and experts, maximized opportunities to adjust inputs in line with changing priorities and opportunities*
- *Innovative mix of domestic and international expert provided cost efficient results.*
- *Wide-ranging consultations –especially with the business community -- and applied studies on constraints and impacts of proposals were critical in building support for reform. Consultations are also expected to facilitate implementation.*
- *Project staff were pro-active in seeking cooperation from the media to raise public awareness of key issues and constraints, and to build support for reform.*

Policy based lending conditional on improved enabling environment

117. Under this form of support, Government and donors engage in “policy dialogue” to reach agreement on a monitorable program of action aimed at promoting the achievement of broadly specified socio-economic targets. Technical assistance is often provided to support the development of the action plan, and to support implementation of elements of the action plan.

118. The major donors providing such assistance to Viet Nam have been ADB, IMF, Japan (the Miyazawa initiative) and the World Bank. Donors such as the Denmark, Sweden, and the UK have co-financed some WB support, but had little direct involvement in negotiating policy reform conditions. The Miyazawa initiative was most closely linked to directly supporting improvements in the enabling environment for SMEs. WB and IMF support was more broadly linked to improving the broad mac-

roeconomic and institutional framework for business development. The WB Poverty Reduction Support Credit (approved in 2001) does include several specific private sector development initiatives which reinforce some of the measures agreed under the Miyazawa initiative. ADB support has been focused on policy reform in the agriculture and finance sector, and in the corporate governance of enterprises, but included initiatives aimed at reducing barriers to private sector development³¹.

The Miyazawa Initiative

The Japanese Government agreed in September 1999 to provide a JPY 20 billion Economic Reform Support Loan to support policy and institutional reform in the areas of; (a) private sector promotion (with a strong focus on SMEs and the development of business associations); (ii) the auditing of 100 large SEs, and (iii) the tariffication of non-tariff barriers to trade.

In reaching agreement on a reform agenda, Viet Nam and Japan were able to build on the JICA funded Viet Nam-Japan Study on Economic Development Policy in the Transition toward a Market-oriented Economy (JVJR) conducted over 3 phases from 1995-2001. This long period of intensive joint research, and high level policy dialogue with a broad range of domestic stakeholders (including the Party), helped the Japanese authorities to be aware of important policy measures for which there was already broad national support and political commitment. This facilitated implementation of the Miyazawa program.

119. Most national observers felt that while there had been substantive dialogue between government and donors on key policy issues that had helped in improving and developing the socio-economic development agenda in Viet Nam³², formal policy based lending had not played a pivotal role in securing reforms. Many felt that, because of the strong national ownership of reform, policy based lending, was only effective when it was supporting reform measures for which there was already a broad national support. Some argued that donor attempts to accelerate reforms where there was no national consensus for reform -- such as the rapid transfer in ownership of State enterprises -- could be counterproductive. Others argued that the budget support inherent in policy based lending has reduced pressure on the Government to implement needed reforms.

³¹ Many major elements of the proposed reform agenda prepared during the preparatory technical assistance for the ADB enterprise reform program were not included as program loan conditions (this loan subsequently focussed on corporate governance issues), but were included in the resolution of the 4th Plenum of the 8th Party Congress (December 1997), and have since been implemented by the Government. This probably is an indication that the proposed reform agenda was developed jointly to be consistent with national development priorities.

³² For example, there was frequent dialogue between donors and the Government (and indirectly the Party) as the recent five, ten and twenty year development plans were being formulated. This dialogue was both at the political level (with embassy and development agency officials), and at the technical level between national and international experts.

Private Sector Actions Addressed under the WB PRSC

Reform measures agreed under the World Bank's Poverty Reduction Support Credit (PRSC) include:

- *removing and/or ensuring simpler, more transparent licensing restrictions on the entry of new businesses in industry, trade and services,*
- *monitoring of implementation of regulatory reforms in different provinces,*
- *issuance of the SME decree,*
- *facilitate the formulation of the domestic business associations,*
- *more transparent land allocation, and improvements in land policy and administration to facilitate the use of real estate as collateral and equity, and*
- *the removal of State dual pricing policies.*

These measures build-on actions agreed under the Miyazawa initiative, and technical assistance financed by other donors aimed at improving the enabling environment for private and small enterprises.

Donor coordination and partnerships

120. Most discussants noted that, while there some very effective partnership between donors³³, formal coordination arrangements and partnerships in the area of SME and private sector development remained weak. The SME partnership group has only met infrequently, and there is no Government counterpart to take responsibility for national inputs to the group. With the rapidly increasing donor interest in supporting SME/private sector development, and some domestic concerns about national capacity to absorb this ODA, improvements in coordination mechanisms are urgently needed. Strong requests were made for action to establish a mechanism for regularly updating and sharing information about donor interventions in the area of SME/private sector development. Several discussants suggested establishing a website for this purpose.

121. Several donors suggested that while sector wide approaches was an option for improving coordination, this was difficult (at least until recently) because of the lack of a single government agency with leading responsibilities for SME development. With the recent decision to establish a SME department within MPI, there may be scope for sector wide approaches in the future.

122. The situation is better at the NGO level, with the SME Forum meeting informally most months. The aim of the forum is to facilitate joint learning and information sharing and dissemination among national and international stakeholders on business

³³ Some examples include the close links between private sector development policy issues promoted by Germany, Japan, UNDP, UNIDO and the WB, and; joint-projects undertaken by UNIDO (with Germany and UNDP funding) at MPI, and by UNDP and AusAID (with IFC support in recruiting international consultants) at CIEM. This latter project worked quite closely with another CIEM based German GTZ project supporting economic reform processes.

development. Participants include representatives of government agencies, business associations, domestic NGOs, and international development organizations. Forum events are organized around themes relevant for business development.

Impact and outcomes of recent donor initiatives

123. Most discussants felt that donor support had clearly helped in terms of transferring ideas and international experiences. Donor training programs have contributed to marked improvements in the policy analysis and technical skills of large segments of the central civil service, research institutions, business associations, and business people. Some donor supported studies had fed into the domestic policy debate and into national planning documents. International experts have contributed to technical improvements in domestic studies and policy and legal drafting.

124. On the other hand, nearly all discussants agreed that the driving force for change was national pressures to make changes to increase investment and employment in order to improve living standards and reduce poverty. Most changes would have happened without donor support, but donor support helped accelerate the process and helped in ensuring that Viet Nam learn from international experience and, thus, to start catching-up more rapidly than might otherwise have been the case. Donor support to education and training has contributed to marked improvements in the professionalism of the civil service responsible for developing and implementing the enabling environment for small enterprise.

125. Another perspective of the impact of donor assistance can be seen by looking at how donors may have affected a number of recent policy initiatives affecting small enterprises in Viet Nam

- *Government-private sector dialogue.* The consensus based approach to policy-making in Viet Nam means that consultative processes were already an accepted party of policy decision making. However, the ambiguous status of the private sector meant that formal consultations with the business community were very limited until recent years. The first public Government-private sectors consultations occurred in the early 1990s, when private conference companies organized foreign investment roundtables with the Government (mostly outside Viet Nam). Now the Government meets with the (mostly foreign) business community twice yearly as part of the Consultative Group process. More importantly, the Government has also met formally with the domestic private sector on a regular basis since the mid-1990s. The Prime Minister now holds a high profile meeting with domestic businesses on an annual basis, with much more regular meetings at lower levels³⁴. CIEM specifically requested that consultative mechanisms be built into the UNDP financed project on improving the business enabling environment when it was being formulated in 1997. Dialogue would have taken place without donor support, but donor support has helped make it more systematic, and in developing bet-

³⁴ The Asia Foundation, for example, supports VCCI in organizing monthly consultations between the private sector and the Government on specific issues affecting business.

ter analysis of the issues. Donor support has probably helped increase the frequency of consultations, and may have helped in broadening the participation in these meetings.

- *Enterprise Law and related business regulation reform.* These reforms were made primarily in response to domestic pressures: there were strong commitments to these changes in Party documents well before the provision of assistance. Limited donor support was provided in response to quite specific requests by the Government for support. Donor assistance helped in improving the quality of analysis that fed into the preparatory processes, it helped in allowing the country to draw on international (and especially regional) experience with enterprise reform, it probably helped in improving the quality of policy and regulatory drafting, and may have helped in broadening consultative processes.
- *SME Decree and SME Department.* A specific regulatory framework for SMEs would probably not be in place without donor support. Party and Government planning and policy documents have included increasingly strong references to important role of the private sector and the need to develop an equitable playing field for all enterprises, but there is no specific reference in these document of the need to provide special support for SMEs. Support from UNIDO/Germany, Japan, ILO and some NGOs have had a major impact in securing these policy and institutional changes.
- *The Comprehensive Poverty Reduction and Growth Strategy (CPRGS).* Poverty reduction has long been a core Party goal, and Government and Party documents have long focused on reducing poverty. Remarkable progress was made in reducing poverty during the late 1980s and early 1990s with little ODA. The Government's Hunger Eradication and Poverty Reduction strategy has been a key element of Government development strategies over the last decade. However, donor agencies helped to broaden the approach to poverty reduction, to broaden consultative approaches, and to include a stronger emphasis on the links between business (especially SME) development, growth and poverty reduction. Access to the WB's Poverty Reduction Support Credit (PRSC) and the IMF's Poverty Reduction and Growth Facility (PRGF) are conditional on the existence of a poverty reduction strategy paper (PRSP) acceptable to the WB and IMF. It is unlikely that the CPRGS would have been produced without donor support.

126. The first two areas of change discussed above were clearly Government led initiatives, where donors helped add value to changes in processes and policies. The impacts of these initiatives are already clearly felt throughout the country. The later two changes are consistent with Government development thrusts, but it is unlikely that the specific changes would have taken place without donor support. It is still too early to assess the impact of these later two changes, but at the very least they have helped raise awareness at all levels of the important role that small enterprises can play in employment creating and poverty reduction.

127. However, there are also concerns that the emphasis on using Government subsidized support as a focus of SME promotion policies, coupled with the strong interest

by donors in expanding and developing new SME support programs, could lead to the introduction of new distortions, and possibly another source of corruption, into the economy.

Summary of Major Donor Support to the Enabling Environment for Small Enterprises*

Type of Support Focus of Support	Joint-Donor Consultations with Government	Direct support to develop new policies and regulations	Institutional capacity building projects	Policy based lending dependent on agreed conditions being met
Stable macroeconomic and institutional environment for businesses development	Consultation on medium-term plans. CPRGS process CG processes, including the VN Business Forum. Partnership groups in related sectors.	IMF, WB, UNDP, ADB, UNIDO, Japan, Sweden, Germany and international NGOs.	UNDP, WB, IMF, ADB, Japan, Sweden, Germany, Canada, France, Australia, Friedrich-Ebert-Foundation (FES, Germany) Asia Foundation and other international NGOs	IMF, WB, ADB and Japan (Miyazawa)
Policy and regulatory environment directly related to SME development	CG process. CPRGS process.	UNDP, UNIDO, ILO, Germany, ADB, Japan, FES and Asia Foundation (USA)	UNIDO, ILO, Germany Japan and international NGOs. Many new donors planning support.	WB, ADB and Japan
SME institutional and policy support to promote SME development	Government and national agencies not yet substantively engaged in SME partnership group.	ILO, UNIDO, SNV (Netherlands), Germany	UNIDO, ILO, Germany, Japan, Netherlands and international NGOs. Many new donors planning support.	Japan (Miyazawa).
Business Associations	VN Business Forum	ZDH (Germany) and Asia Foundation.	UNDP, UNIDO, ILO, DANIDA, MPDF, Asia Foundation, Oxfam (Canada), ZDH (Germany).	Japan (Miyazawa).

* in addition a number of donors providing general education and training support which is essential to effective implementation of all other donor activities.

5. *FURTHER DEVELOPING THE ENABLING ENVIRONMENT*

128. Despite recent progress, much remains to be done. Consultations on business issues are still done on an *ad hoc* basis. Recent reforms have not been consistently implemented in all sectors and provinces. The legal basis for establishing business associations is still to be finalized. Progress in reducing barriers in one area is often (at least partially) undermined by administrative inertia, or new, sometimes conflicting decisions and circulars emanating from line ministries and/or provincial authorities. National institutions responsible for ensuring compliance with business regulations remain weak. This might suggest a need for substantial additional donor assistance.

129. On the other hand much has been achieved in improving the enabling environment with limited donor assistance. The enabling environment, while far from perfect, is now much less of a constraint to business development. Given this, and the importance of national ownership of reform initiatives, strong arguments would be required to justify any substantive increase in support to the enabling environment for small enterprises.

Emerging trends with donor assistance

130. Donor interest in supporting SME development, including improvements in the enabling environment, has grown rapidly since the enactment of the Enterprise Law, the promulgation of the SME decree, and the resolutions of the 5th Party Plenum. The SME decree is seen by some as providing opportunities for rapid increases in donor support to SMES. Several major donors have committed to developing projects related to strengthening the capacity of the new SMED in MPI. This raises important questions of absorptive capacity. A number of discussants expressed concern about the risk of running into the same absorptive capacity problems that were encountered when there was a rapid escalation of TA support to SOE reform in the late 1990s. They stressed the need for cooperation between donors in developing these programs, and for special attention to developing transparent systems to ensure that donor subsidized support to SMEs reach intended beneficiaries. Concerns were also expressed about developing SMEs reliant on donor subsidized funding. Careful planning of future support, and better donor coordination, will be required to allay such concerns.

Improving donor coordination

131. Most discussants called for improved coordination arrangements for donor support to SME and private sector development. This was needed because of rapidly increasing donor interest in supporting SME development, and concerns about national capacity to absorb this ODA. Some donors noted that, while sector wide approaches was an option for improving coordination, this was difficult because of the lack of a single government agency with leading responsibilities for SME development. There were calls for action to establish a mechanism for regularly updating and sharing information about donor interventions in the area of SME/private sector development. Several donors suggested establishing a website for this purpose.

Providing more flexible donor support

132. Reform processes are difficult to predict in advance. Opportunities for change can emerge quite unexpectedly, and may be stalled for reasons that are difficult to predict. Thus, it is very difficult to predict outcomes of support with any certainty. Traditional projects -- with clearly defined outputs, activities and milestones -- are often inappropriate vehicles for supporting reform. More process oriented support is needed to allow donors to better respond to emerging needs. Such support is often risky and requires more skilled professional support from donor agencies during implementation, but the potential pay-offs can be large. Some of the strategies recently adopted by donors to provide more flexible support are described in the following box.

Donors Strategies for Flexibility in Responding to Emerging Needs

In recent years, donors have adopted different strategies to provide greater flexibility to respond to emerging needs. Examples include:

- *The Mekong Project Development Facility was developed by several donors to pool their support directly supporting business development planning. While the focus of MPDF activities is on direct support to businesses and strengthening business development services (BDS), it has also funded studies aimed at influencing emerging debate about the enabling environment for business.*
- *UNDP has moved from planning activities for the life of projects (usually 2-4 years) to annual planning of activities within guidelines established within a longer-term project design. The recently approved follow-up project on improving the regulatory environment for business is using this approach.*
- *AusAID recently established a Capacity building for Effective Governance (CEG) facility aimed at providing the flexibility to respond to emerging demands for technical support to improving governance, including improvements in the private sector enabling environment.*
- *Some donors (e.g., DFID) have decentralized some decisions to field offices, thus providing more flexibility in responding to emerging opportunities for support.*
- *Germany is considering the establishment of a Reform Support Fund, to fund short to medium-term support for reform via advisory services, research support and training. The Fund approach would allow activities to be tailored more directly at emerging needs within appropriate partner agency, with continued funding dependent on progress in producing expected results.*

Priorities for future donor support to the enabling environment

Education and training

133. All discussants highlighted implementation as a key problem. National ownership of reforms was seen as pivotal to implementation, but human resource devel-

opment was also seen as important. Education and training is needed to develop the local policy analysis skills which can help build ownership. It is an essential element of efforts to develop the institutions needed to promote a competitive market economy. Training can help Viet Nam to learn from experiences elsewhere in the world and can facilitate substantive policy dialogue with donors. Education and training already provided by donors (both in-country and foreign) has already contributed to a tremendous transformation in national understanding of market economies and institutions. The effectiveness of current assistance has been greatly enhanced by the training provided in the last decade.

134. Despite the improvements, there continues to be substantial unmet demand for professionally trained expertise in accounting, auditing, banking, business, economics, finance, insurance, law, office management, real estate, risk analysis, valuation, etc. Such skills are needed by government, business associations, businesses services, businesses, market institutions and training organizations. They are needed at all levels of the economy. Training would appear to be a very low risk strategy for donor support to the enabling environment for small enterprises.

Long-term investments in capacity building

135. In addition to human resource development, there is need for focused support to strengthen the institutions that are essential part of an effective enabling environment for small enterprises. Some key institutions include:

- *Government agencies.* SMED and the business information centre within the Enterprise Department of MPI, provincial business registration offices are immediate priorities. There may also be opportunities to work with other government agencies directly interacting with small businesses, including the ministries of finance, trade, and labor to streamline services and approval processes.
- *Policy research institutes.* CIEM has played a crucial role in improving the enabling environment, but could benefit from additional support. There is also need to strengthen further the capacity of the Institute for Economic Research and to begin developing institutes in other provinces with similar capacity. There is also need to develop the capacity of other policy research organizations -- for example at academic institutes -- to provide independent analysis of policy and institutional issues affecting business.
- *Business associations.* There has been a rapid expansion in the number of business associations in recent years, but they typically have limited capacity to analyze substantively business constraints or to develop submissions on policy issues related to the enabling environment. Capacity of business associations outside the main urban centers is particularly weak.
- *Judiciary.* Major long-term efforts are required to strengthen capacity. Training of professional staff, development of domestic training institutions, and improvements in the organization and management of the court system are all needed for the judiciary to positively contribute to an improved enabling environment for business.
- *National Assembly and People's Councils.* Elected representatives at the national and provincial level are now more involved in representing business in-

terests. These institutions require strengthening to play this role more effectively.

136. A practical way to develop institutional capacity could be for donors to provide technical and training support to implement domestic policy studies on key issues affecting business. Examples of possible studies could include:

- Reviewing regulatory and administrative barriers to development of particularly sub-sectors and industries using public consultation processes.
- Analysing inter-province differences in implementing policies and regulations on business investment and employment generation. Use this as a base for developing best practices.
- Approaches to developing private-public partnerships to address practical barriers to business development at provincial and district levels.
- Analysing weaknesses in market institutions that constrain the development of small enterprises in rural area.
- Options of increasing the use of non-residential land as collateral for debt financing investment in small enterprises.
- Assessing the impact of high costs caused by State monopolies (e.g. in telecommunications) on the competitiveness of small businesses.

137. Such studies would not only help in institutional strengthening, but also in building support for further reform. Facilitating the development of links with appropriate industry, service and foreign business related organizations would be another relatively straightforward approach to developing capacity.

Provincial and district public administrative reform

138. Most small businesses have to deal primarily with district and provincial level officials. Thus, it is important that provincial and district level administrative units be strengthened. Support is needed in increasing awareness of the economic role, rights and obligations of the business sector, streamlining business processes, and to develop private-public partnerships at the local level and improve mechanisms for consulting with the business community to remove bottlenecks to increased business investment and employment.

139. Most donor assistance at this level is provided as a relatively minor part of provincial public administration reform or other provincial level projects. A number of national discussants felt that they saw this one of the more obvious gaps in donor assistance. Others expressed caution, noting that there were few examples of successful donor support to reform provincial level administrations.

Land policy and administration reform

140. Reforming land policy and strengthening land administration systems will be a key challenge in improving the business enabling environment over the next 5-10 years. Land use rights and buildings are the major assets of most small enterprises. Existing titling systems and regulations make it difficult to full utilize these assets to mobilize additional business investment. Most small businesses start off using residential land for business, but often face difficulties when they need to acquire additional land

in order to expand. Restrictions on maximum size of land holdings has helped in ensuring equitable distribution of resources, but also acts as constraint to the development of livestock, some industrial crops and agro-business development. These are all issues that need to be addressed over the next 5-10 years, and donors could contribute by sharing international experiences and funding institutional development, including land titling.

Cheaper access to better information

141. Access to timely, low cost information is an increasingly important prerequisite for business development, and is essential to accessing and competing in most export markets. Donors can continue to show how restrictions on information flows, and high costs caused by monopolies restrict small business growth and employment. They can help develop information services, and improve the use of information technology to increase efficiency and transparency in public services used by business. They can also take steps to make it easier for genuine small business people to travel to developed countries to develop business opportunities.

Trade Facilitation

142. The single most important support donor could be provide would be to reduce barriers to small business selling their products in the markets of developed countries. Barriers to export of agricultural products, handicrafts and garments are particular problems of small business in Viet Nam.

143. Internationally recognized quality certification is becoming an increasing concern for small business exporters, especially for food products. Donors could assist in developing certification capacity to meet international standards for certification related to food safety, environment standards, and organic production.

144. There is also considerable scope for further improvement in customs administration. Donors could provide support with training, expertise, hardware and computer software.

Suggestions for broader follow-up action

Improving Donor Coordination and Partnerships for SME Support

145. Discussants highlighted concerns about the relatively poor donor coordination in support to SMEs, and weaknesses in the partnership group for SME Promotion and Private Sector Development (PG-SME). The minimum improvement needed is regular updating and sharing of information on donor support to SMEs. An outline proposal for a website to facilitate such information sharing is attached as Appendix 1.

146. The proposed web based information system on donors support to SMEs should eventually be extended to allow any interested parties to download project design and monitoring documents, SME project studies and consultant reports, and listings of planned future donor support to SMEs.

147. Concerns were also raised about the need for more frequent and substantive meetings of the PG-SME. There were calls for more specialized (sometimes technical) meetings on issues related to specific subsets of donor support to SMEs. Agendas of

each meeting should be distributed in advance so that PG-SME members could be selective in attending meeting relevant to their own support programs. Not all members would benefit from attending the more technical sessions.

148. Stronger involvement of domestic agencies was seen as crucial to improving the relevance and impact of the PG-SME. The recent establishment of the new SME Department in MPI (SMED) provided an opportunity for improvement. Donors should be prepared to support any domestic efforts to lead the WG-SME.

149. In addition, regular meetings of the core group of donors that are directly supporting (or proposing to support) the SMED could be useful.

Study to understand domestic stakeholders' perception of donor support

150. The focus of this study was on donor's perception. The nature of the study and limited resource meant that consultations with domestic stakeholders were limited. Donors could learn much from commissioning a similar study to be implemented largely by a domestic consulting firm to assess the perception of domestic stakeholders on the role of donors in improving the enabling environment for small enterprises, and domestic stakeholders' perceptions of best and worst practices. Such a study should probably include a formal survey of key stakeholders. International input to such a study should be limited to advice on study design, and support in policy analysis.

Developing a sector wide strategy for small enterprise development

151. The national level study on the impact of donor support to improve the enabling environment for small enterprises could help in laying the foundations for the Government to develop a medium-term strategy for small/private enterprise development that could be supported through basket funding from a number of donors.

Increased transparency of donor support to SMEs

152. Concerns were raised about how much of donor subsidized support actually results in additional support to SMEs. There were calls for simple and transparent rules on accessing donor support to be regularly published in the news media, and for regular (say quarterly) publication of actual recipients of subsidized support at the local level. More publicly accessible information on the distribution of donor subsidized support was seen as important in increasing accountability. The development of cost-effective mechanisms for increasing the accessibility of information requires further study.

Summing-up

153. Donor interest in supporting improvements in the enabling environment for small enterprise development in Viet Nam has increased substantially in recent years with a substantial pipeline of new projects at various stages on formulation. It is important to recognize that the absorptive capacity of institutions directly targeting SMEs is limited. When donors are planning support to SMEs, it is important to recognize that many of the improvements in the enabling environment that are likely to have the biggest pay-offs are not obviously classified as projects supporting improvements in the enabling environment. The development of business associations, services and media,

the reform and streamlining of local level public administration, the development of a broad range of skills and training capacity, developing a professional and credible judiciary are just some examples of areas where improvements could greatly improve the enabling environment for business.

6. CONCLUSIONS AND LESSONS LEARNED

Role of donor support in improving the enabling environment in Viet Nam

154. National ownership of the reform agenda. Strong national ownership of the reform process has been crucial in successfully implementing change. Domestic commitment to improving the enabling environment for small enterprise development derives primarily from domestic pressures to increase employment and incomes. This pressure has been particularly acute during periods of economic instability and stagnation, sometimes caused by deteriorating external circumstance such as the break up of the former USSR in the late 1980s and the Asian financial crisis from 1997.

155. National commitment to improving living standards. Without a strong national commitment to improving living standards through business development, donor support is unlikely to have had such an impact. Experiences from Viet Nam may not be applicable to countries that lack this commitment. However, where commitment is weak, donor support in developing clear analysis of the employment, equity and poverty alleviation impacts of improvements in the enabling environment may help in developing commitment for change.

156. Donors have helped implement national reform initiatives. In some cases, donor support has facilitated, and very likely improved, the formulation and implementation of Government initiated measures to improve the enabling environment (e.g., the Enterprise Law and related regulatory reforms, and increased Government-business dialogue). These Government initiated examples have already had substantial impacts on business investment, and employment growth, and thus on reducing poverty. These impacts are almost certainly greater because of donor support. Donors have also contributed to, and probably helped raise the profile, of public policy debate on competition policy and monopoly regulations.

157. Donors can influence the policy agenda. In other cases, donor support has resulted in the issuance of new policy documents (e.g. the CPRGS) or regulations (e.g., the SME decree) that -- while consistent with the thrust of Government policy -- are unlikely to have been issued in that form without donor support. Donors have also raised the profile of policy debate on competition policy and monopoly regulation.

158. Donor led initiatives have had positive impacts, but sometimes cause a degree of ambiguity. Donors see SME support as an important vehicle for supporting private sector development, while SME development policies in Viet Nam are directed at SOEs, cooperatives and the private sector³⁵. SME is a term that is rarely used in national planning documents such as the recent (March 2002) Party Plenum resolution introducing reforms aimed at promoting private sector development.

159. Approaches to donor support. Donor support to the enabling environment has included assistance directed at: (i) providing a stable macroeconomic and institutional

³⁵ It is not clear whether donors used the term mainly because until recently it was a more politically neutral term in Viet Nam than focussing on private sector development, or if it was because of donor experience in supporting SME development elsewhere (in countries where SMEs were never considered to include SOEs).

environment; (ii) improving the policy and regulatory environment directly related to SME development; and (iii) strengthening institutions and policy implementation to promote SME development. The modalities of donor support have included: (i) joint donor dialogue with the government on enabling environment issues; (ii) direct support to new policies and regulations; (iii) institutional capacity building, and (iv) policy based lending. Most discussants felt that there was a role for all modalities, but perceptions on policy lending varied. Most agreed that, because of the strong national ownership of reform, policy lending was only effective when it was supporting reform measures for which there was already a broad national support.

160. While the focus of this study has been on donor support to improving the enabling environment for small enterprises, much larger amounts of donor money have been directed to donor subsidies for SME credit and business development services in Viet Nam. But it has been improvements in the enabling environment that have had the major impact on SME development. The Enterprise Law and the related business regulation reform were pivotal in the recent rapid growth in private SMEs. This raises questions about the utility of donor support to SME promotion in the absence of a supportive enabling environment. This is a complex issue which cannot be addressed here. However, having raised the issue, it is noted that some argue that active involvement in providing SME services helps donors understand practical business constraints, and increases the credibility of dialogue with the Government on enabling environment issues. The MPDF and the UNIDO (Germany) support to SMEs are examples of projects where such arguments have been made.

161. Intermediate outputs of donor support. Tangible direct outputs of donor support to the enabling environment included (i) increased awareness of the potential benefits of small enterprises in increasing employment and incomes, reducing poverty, and promoting balanced debate; (ii) developed capacity to analyze issues related to business development; and (iii) providing information on international approaches to improving the enabling environment for business development.

Lessons learned: opportunities to improve donor support

Formulating donor assistance

162. National ownership is crucial. National ownership of reform processes and donor support for these processes has a major bearing on the impact of donor assistance. This cannot be achieved through a project designed primarily by external consultants visiting Viet Nam for a few weeks. Counterpart agencies need to play a leading role in defining TA needs and be actively involved in Project design. Counterpart and funding agencies should have a shared view of needs and the role of donor support. This usually requires protracted dialogue between counterpart and donor agencies. Where a donor is working with a counterpart agency for the first time, a preparatory phase of assistance can help identify needs and opportunities, and build effective partnerships between donors and counterparts.

163. Understanding the national context for reform. A realistic assessment of the national context before undertaking policy reform efforts facilitates the formulation of

donor support that addresses national needs. Tools that donors have used to develop their understanding of reform processes include:

- Consulting widely with a broad range of stakeholders to develop strategies – including a vision of the expected outcome of this support -- for supporting special studies before starting assistance.
- A phased approach to the design and provision of assistance can help donors to learn by doing.
- Case studies of what has worked, and not worked, in particular sectors and/or provinces can help in understanding reform processes.
- Dialogue with officials on the development and reform processes in other developing countries can help in developing understanding constraints and issues facing policy makers in Viet Nam.

164. Need for flexibility. Concerns were raised that both donors and the Government coordinating agencies were not sufficiently flexible in responding to changing circumstances. Opportunities to help improve the business environment often emerge unexpectedly. Projects supporting improvements in the enabling environment need to act quickly in responding to emerging opportunities to affect change. At the same time, when project activities depend on high level decisions, delays are almost inevitable. Thus, there is also need for flexibility (by Government and donors) in delaying support. A strong professional relationship between the counterpart and donor agency can help in providing flexibility in responding to changing needs. A strong commitment by managers of donor agencies is needed during implementation.

165. SME institutions are only one element of the enabling environment. Donors do not need to finance “SME projects” to support improvements in the enabling for small enterprises. Many of the major enabling environment issues facing small enterprises are also key issues in the broader development agenda. Reform issues that are likely to have major impacts on small enterprises development include: (i) public administration and regulatory reform; (ii) land policy and administration systems (iii) taxation; (iv) access to information; (v) financial services; (vi) contract enforcement; (vii) business associations and improved advocacy support; (viii) increased local involvement in planning infrastructure and services.

Project organization and timing issues

166. Integrate to build capacity. Many donor supported projects establish (formally and informally) project management units to implement projects. These can be problematic in any project, but especially for projects supporting institutional reform and development. Commitment to donor projects is often strongest when assistance is integrated into supporting core responsibilities of counterpart agency, and when project activities, management, staffing and reporting are – to the extent possible -- integrated within the counterpart agency. Projects that are established outside the counterpart structure can impose additional burdens on limited financial and human resources. It can also result in difficulties in accessing counterpart staff, limit informal contact between international and counterpart staff, restrict access to policy makers, delay decision-making, and losses of potential gains from institutional strengthening.

167. Matching counterparts and donors. Support to reform is most likely to be effective when donors work with agents of change in a strong institution, with which the donor has established a substantive relationship. Such counterparts are in short supply and, consequently are often swamped with offers of donor support and face difficulties in supplying adequate counterpart staff on a regular basis. There is a danger that counterparts will respond to excess supply of ODA by agreeing for surveys or studies that may add little value to the process of change. In this regard, a number of discussants pointed to the frequent surveys of private sector development constraints.

168. One option to address this problem is for donors to look for opportunities to support weaker institutions, especially at the local level where many of the remaining problems facing small enterprises are now encountered. This is not an easy option, the risks of failure may be higher, but the potential national benefits may be greater.

169. In sensitive reform areas, high level counterparts may prefer support from donor agencies perceived as “neutral” or less ideological in the provision of advice. At times, counterparts may prefer multilateral donors that may be more likely to provide a mix of international perspectives to sensitive issues. At other times, there may be a preference for support from a donor with long established development cooperation relationships. Donors should be alert to the possibility of such sensitivities.

170. Reform takes time. Some donors typically provide very short-term (3-18 months) assistance for most projects. The institutional reform and development needed to affect substantive improvements in the enabling environment takes time. Donors need to take a medium-term (5-10 years) perspective in providing support to improve the enabling environment (even if individual projects have a shorter time-frame). Time and careful analysis is needed in preparing technical assistance to support reforms. While donors may feel confident about what an ideal enabling environment should include, the process of realizing this improvement is always much more complex.

Changing attitudes and building support for reform

171. Social attitudes are important. Some donor projects have focused on a narrow constituency. Business, media, legislators and industry organisations are becoming increasingly involved in efforts to improve the enabling environment for business. Support from senior Party and Government leaders can facilitate implementation. Donor assistance can be improved by working with a broad range of stakeholders to formulate and implement support aimed at improving the enabling environment.

172. Understand the distributional impacts of reform. Not all stakeholders will benefit from change. Thus, some may resist change. Analysis of the distributional impacts of the reforms promoted by donors has been weak, and often non-existent. Developing capacity to analyze and report on the distributional impacts of proposed changes can help in addressing resistance to change.

173. Disseminate information to build support. Assisting domestic institutions to publicize, and publicly debate, policy studies, draft legislation, and related documentation can help build support for change. Well-structured workshops can help build awareness of business concerns, and the realities of implementing business policies and laws. Comparative studies can also be a useful tool in building support for reform, especially when domestic institutions are actively involved in undertaking comparative

analysis. Where possible, the media should be invited to workshops and receive information on findings of key studies.

174. The justification given for reform is important. Project and project activities that are justified on the basis that they will help create employment, reduce poverty, and promote equitable development may find it easier to attract high level support than similar project activities that stress objectives of promoting private sector development and/or privatization of SOEs. This may be one reason that donors initially have focused on SME development rather than private sector development.

Use of consultants

175. Efficient use of consultants. The mix of consultants (domestic/national and short/long term) is a critical issue. Long-term experts are expensive and may often be underutilized. On the other hand, long-term consultants can play a crucial role in developing the informal relations with counterparts that can be critical to understanding domestic issues and priorities, and to understanding what types of support is most likely to be effective. Program approaches and sector wide approaches could help to ensure that long-term consultants are more intensively utilized³⁶.

176. Develop domestic consulting capacity. Many discussants felt that domestic consultants have been under-utilized. Greater use of domestic consultants can be cost-effective, help strengthen domestic capacity, and can be more effective in developing a domestic constituency to support reform. Opportunities to use domestic consultants are increasing as (i) domestic capacity develops, and (ii) the Government becomes increasingly open in working with non-State domestic experts.

177. Consultant selection processes. Government officials noted considerable variability in the effectiveness of consultants. They noted that not all “experts” supplied by donors were familiar with the latest practical and theoretical developments in their area of expertise. Strong inter-personal and communication skills are also crucial in supporting reform processes. Government officials requested increased involvement in selection decisions. Counterpart agencies often prefer consultants to have a broad comparative experience of Asian and transition economies.

178. Increase use of information technology. A wide range of international expertise can now be tapped in a cost-effective way using new information technology. International consultants can comment on study designs, draft reports, and draft regulations by internet and Email. Considerable comparative information, reports on best practices and other data can be downloaded from the Web³⁷.

Training

179. Exposure to international experience. The increase in skills levels within national institutions over the last decade is one of the most visible direct impacts of do-

³⁶ GTZ has tried to base long-term experts at key counterpart agencies but with responsibilities for other related projects in order to increase cost-effectiveness of long-term consultants.

³⁷ For example, the OECD work on regulatory reform was particularly useful for the UNDP supported project on Improving the Regulatory Environment for Business. In addition to field visits, comments on draft laws and regulations were also provided by Email at low cost under this project.

nor support. A combination of overseas graduate and post-graduate training, specialized training, workshops, study tours and on-the-job training has contributed to a remarkable change in the way national institutions do business. It has also increased the scope for meaningful dialogue on business development issues.

180. Need for clear training objectives. On the other hand, not all training is perceived as effective. There is a frequent perception that too many donor funded study tours and workshops are not particularly effective. Careful preparations are seen as crucial to getting value about of study tours and workshops. For example, the management of one successful project³⁸ generally required clear statements of study tour objectives and the information being sought, and that detailed drafts of study tour reports be prepared, before fielding any study tour. Management was also pro-active in contacting host-country institutions to ensure that hosts were well briefed on study tour objectives. Under this project, one study tour report on comparative ASEAN business law fed directly into a Government report circulated to members of the National Assembly prior to consideration of the new Enterprise Law.

181. Trainee selection. A major challenge facing donors is to ensure that appropriate trainees are selected for training. One problem is that sometimes less than transparent procedures are used in the selection of beneficiaries of training activities.

182. Getting training incentives right. A more systematic problem is the standard practice of most donors in paying *per diems* to attend training. This has a strong adverse selection bias. Those with minimal work commitments, and limited opportunity cost for their time, may attend training just to get the *per diems*. This sometimes results in large class or workshop sizes that may discourage potential trainees that are most likely to benefit from such training. Paying people to attend can reduce the incentive for trainers to deliver quality training. Many donors, consultants, and national institutions are aware that this is institutionalized bad practice, but still the practice continues. If short-term training is well prepared and relevant then participants should not have to be paid to attend.

183. Willingness to pay for quality training. Vietnamese have demonstrated a willingness to pay for quality training through the high levels of attendance at private after hours training courses. The rapid increase in private short-term vocational training services suggests that caution is needed in analyzing whether donor support is needed for such training.

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APPENDIX I: PROPOSAL FOR IMPROVED INFORMATION SHARING ON DONOR SUPPORT TO SMEs

Background

Most donors and national discussants agreed that the coordination of donor support to SMEs had not been effective, and was likely to be an increasing problem with the entry of new donors to this area. They suggested that a first step to improving this situation was to establish a system for the regular recording, updating and dissemination of information on donor support to SMEs. During the current study, many donors provided summary information on all their projects supporting the SME sector, and a compilation of these projects are available as a separate volume. The following proposal suggests a mechanism for regular updating of this information.

Proposal

The existing table on donor financed projects supporting SME development should be incorporated on a Web site. Donors could then review and update information on their projects as appropriate and submit them to the Web manager.

Later this site could be expanded to include project design, study, and evaluation reports. It could also include material on best practices and links to international experiences and best practices.

Implementation

Ideally, the site would be managed by the government agency responsible for SMEs. In order to sustain current momentum, a donor might set up the basic information collected during this study on their Web site.

Estimated financial costs

The site could be established with a one month input from a domestic Web designer (USD1,2000), and could be maintained with say two months of work per year (\$2,400). The site could be established on an existing server for a total cost of less than \$300/year. Additional costs would be required to extend the site to include project reports and best practices.

APPENDIX 2: SELECTED DEVELOPMENTS IN ENABLING ENVIRONMENT FOR SME/PRIVATE SECTOR DEVELOPMENT IN VIET NAM

Major Reform (Policy Regulatory Decision: Number and date)	Major Domestic Agencies Involved	ODA Support provided	Outcomes	Outstanding Issues
A. OVERALL SME POLICY/REGULATORY/INSTITUTIONAL ENVIRONMENT				
1992 Constitution	National Assembly		<ul style="list-style-type: none"> Provides recognition and some protection of the rights of non-State sectors in a "multi-sector" economy. 	<ul style="list-style-type: none"> "Private enterprises" still a taboo word despite Constitutional change. Bias against private sector continued.
Revision of the 1992 Constitution (November 2001)	National Assembly		<ul style="list-style-type: none"> The private sector is officially recognized to be an integral part and a key element of the national economy. Helps breakdown remaining "taboos" against private enterprise. 	<ul style="list-style-type: none"> The State is still to play the "leading role" in the economy.
Social Economic Development Strategy 2001-2010 adopted by the Congress of the CPV in April, 2001. (Central Committee Report)		Donors prepared discussion papers and organized discussion between donors and Government on draft documents	<ul style="list-style-type: none"> Emphasizes importance of "multi-sector" economy and private sector. Encourages development of private enterprises, cooperative and foreign investment Strong statement on removing discrimination to create a "level playing field". Strong focus on developing market systems. 	<ul style="list-style-type: none"> Continuing ambiguity with statements that the State is to "play the leading role in the economy". Details implementation plans still to be prepared.
Resolution No.5 of the Communist Party of Vietnam	Economic Commission, CPV		<ul style="list-style-type: none"> Party gives less equivocal endorsement of the role of the private sector paving the way for further improvement in enabling environment. Party members who already have private business can retain their party membership. Emphasizes that attitudes towards private enterprise and profit need to change and notes that Party and the Government needs to promote a more pro-private sector environment. 	<ul style="list-style-type: none"> Key challenge is successful implementation of the Resolution by governmental ministries, local authorities.
Legal Needs Assessment	Ministry of Justice, National Assembly, Supreme Court, GCOP, and other agencies.	Most major donors have supported the process.	<ul style="list-style-type: none"> Provides a framework towards a prioritized strategy for improving the overall legal framework, and needs for ODA to support this process. 	<ul style="list-style-type: none"> Implementation should start during 2002.

Major Reform (Policy Regulatory Decision: Number and date)	Major Domestic Agencies Involved	ODA Support provided	Outcomes	Outstanding Issues
B. BUSINESS LEGISLATION				
Private Enterprise Law and the Company Law (1990)	CIEM (MPI)	Limited support from SIDA (Sweden)	<ul style="list-style-type: none"> For the first time ever, companies in private ownership are recognized by laws. Approximately 30,000 private companies were established within 9 years of validity of the law (1991-2000) 	<ul style="list-style-type: none"> These laws were replaced by the Enterprise Law in 2000.
Enterprise Law (2000) and related implementing regulations.	CIEM (MPI), VCCI	UNDP, GTZ UNDP is committed to support further revisions to this legislation.	<ul style="list-style-type: none"> In a recent Government meeting, the law has been evaluated as: (i) a breakthrough in economic thinking; (ii) great stride in ensuring the business autonomy; and (iii) a big step forward in public administration reform. Business licensing process has been greatly improved and shortened. As of April 2002, some 41,000 enterprises were established under the Enterprise Law with total registered capital of USD 3.6 billion. 	<ul style="list-style-type: none"> Implementing rules need strengthening. Negative attitudes to private enterprises by some State agencies continue. Formal enterprises are concentrated in more developed provinces (Ho Chi Minh City, Binh Duong, Dong Nai, Hanoi, Hai Phong, Da Nang). Government to approve a uniform business laws (for State, private and cooperative enterprises) by 2005.
Decision 19/2000/QD-TTG revoking business licenses. Decree 30/2000/ND-CP abolishing some business licenses. Decree 59/2002/ND-CP removing some business licenses.	Enterprise Law Implementation Taskforce (MPI) CIEM	UNDP (AusAID) have supported the task force.	<ul style="list-style-type: none"> More than 160 business licenses revoked. Other ministries have removed business licenses Demonstrates Government determination to streamline business licensing process 	<ul style="list-style-type: none"> Other licenses still to be reviewed by Enterprise Law Task Force. Resistance from various ministries and authorities against abolishing business sub-licenses. Enterprise Task Force is considering issuing a Decree listing those business licenses which are still required.
Domestic Investment Promotion Law (promulgated in 1994 and revised in 1998)	CIEM (MPI)	GTZ and UNDP.	<ul style="list-style-type: none"> Provides domestic investors with many of the same incentives and privileges that were already available to foreign investors. 	<ul style="list-style-type: none"> Complicated, opaque procedures limit access to incentives. Would be better to have one investment law for domestic and foreign investors.
Cooperative Law Resolution of the 5th Plenum, CPV on cooperatives Decree 90/2001/ND-CP	Vietnam Cooperative Alliance, CIEM, MPI	GTZ, FES Institute, ILO	<ul style="list-style-type: none"> Strengthens cooperatives, gives them more autonomy and requires them to be more commercially oriented. SME decree includes cooperatives as SME. 	<ul style="list-style-type: none"> Economic role of cooperatives is small. Governance of cooperatives is weak. Some remain indebted. Others are non-operational and need to be closed. Bias and negative attitudes against cooperatives remain.

Major Reform (Policy Regulatory Decision: Number and date)	Major Domestic Agencies Involved	ODA Support provided	Outcomes	Outstanding Issues
Decree No.90/2001/ND-CP of the Government on SME Development	MPI	UNIDO (Germany), Japan, ILO	<ul style="list-style-type: none"> Officially defines SME. Legal basis for institutional support for SME development established (to improve access to land, credit, technology, market information, business services) May be a first step in a shift from managing enterprises by "economic sector" (i.e. ownership) to managing by "size". This may reduce discrimination against private sector. 	<ul style="list-style-type: none"> Establishment of new institutions, including the SME Department and SME Promotion Council is still under preparation. Decree aims to support private and State SMEs . State enterprises may be able to use access to decision makers in gaining access to subsidized support. Is the focus on management by size, better than a focus on ownership?
Bankruptcy Law (1993)	Supreme Court, Ministry of Justice, CIEM	UNDP/WB provided support for first law.	<ul style="list-style-type: none"> Provides a legal framework for creditors to recover debt. Such a framework is essential for increasing access to credit, and reducing the cost of capital. 	<ul style="list-style-type: none"> Negative social attitude towards bankruptcy. Procedures are too complicated: the law is rarely used and not achieving its aim. A revised law is being drafted and it is anticipated that it will be passed by the National Assembly by the end of 2002.
C. RELATED REGULATORY REFORMS (LAND, TAX, LABOR, COMPETITION POLICIES)				
<i>Credit and SME financing</i>				
Law on State Bank of Vietnam and Law on Credit Institutions	National Assembly, SBV MOF and MOJ	WB, IMF, ADB, Canada, France, and Germany.	<ul style="list-style-type: none"> Improves legal framework for banking and financial services 	
Decrees 165/1999/NDCP on secured transactions; 178/1999/ND-CP on loan security of credit institution; 08/2000/ND-CP on registration of secured transactions. Decision 546/2002/QD-NHNN on negotiated interest rate mechanism	SBV	WB, IMF, ADB, Canada, France, and Germany.	<ul style="list-style-type: none"> More autonomy for commercial banks to lend to enterprises (regardless of their ownership structure) without collateral. Several banks have set up SME credit funds. Private enterprises are increasingly considered to be highly potential clients. Interest rates have been substantially liberalized and commercial banks now can make loans at "negotiated" rates, paving the way for a "risk-based" lending mechanism. 	<ul style="list-style-type: none"> Banks still reluctant to offer unsecured loans to private enterprises. Foreign banks are constrained in providing services (savings/ credit) to local enterprises. Most bank lending still directed to State enterprises. Banks still face problems in foreclosing mortgages and taking bankruptcy action.
Decision. 193/QD-TTg on SME Credit Guarantee Fund	Ministry of Finance and State Bank	JBIC, EC, UNIDO and World Bank.	<ul style="list-style-type: none"> Legal basis for guarantee funds established. 	<ul style="list-style-type: none"> Implementation has not yet started.

Major Reform (Policy Regulatory Decision: Number and date)	Major Domestic Agencies Involved	ODA Support provided	Outcomes	Outstanding Issues
Decree.43/1999/ND-CP on State Investment Credit and Decree 50/1999/ND-CP on the Development Assistance Fund.	MOF		<ul style="list-style-type: none"> • 337 loans given to private enterprises in 2000 and about 700 in 2001. • Private enterprises and SOEs are meant to be treated equally in securing loans from the Fund. 	<ul style="list-style-type: none"> • Most (77.2% in 2000) funds lent by DAF go to SOEs. • Concerns about transparency.
Decree 48/1998/ND-CP on establishing the stock market	State Securities Commission	IFC, UK and other donors, and private companies.	<ul style="list-style-type: none"> • Stock market provides a new source of capital for private enterprises, and stimulates trading in debt securities. • Stock market launched in Ho Chi Minh City, and plans to establish in Hanoi soon. 	<ul style="list-style-type: none"> • Few listed companies • Equitization process is slow. • Inconsistencies in laws/ regulations. • Information disclosure/ governance. • Lack of institutional investors.
Land				
Land Law in 1993 Revised Land Law in 1998 Law on Land Use Tax	General Department of Land Management	Sweden, Australia, UNDP and WB	<ul style="list-style-type: none"> • Moves to set up a legal framework for unified management of land. • Revised law, land could also be allocated for other non-farm purposes. • Some provinces are constructing industrial zones for SMEs. • A number of land-related incentives under the Promotion of Domestic Investment Law. 	<ul style="list-style-type: none"> • Private enterprises access to land for business purposes remain difficult. • Land rental in industrial zones is expensive. • Procedures for changing land use to business purposes is complicated. • Many SMEs have no land-use certificate. This restricts access to credit. • Transactions of land and immovable property rights are not transparent. • Property registration systems are weak.
Labor				
Labor Law Revision of the Labor Law (2002)	Ministry of Labor, War Invalids and Social Affairs	ILO and bilateral donors have provide support	<ul style="list-style-type: none"> • A legal framework for the labor market has been established. Prior to <i>Doi Moi</i> labor was not allowed to be "bought and sold". 	<ul style="list-style-type: none"> • Law is restrictive and can discourage employment and/or compliance. • No special provisions to meet the special conditions of SMEs.
Access of Export Market				
Decree No. 57/ND-CP issued on 31 July 1998 by the Government Customs Law (June 2001 and effective in 2002)	Ministry of Trade	UN agencies, WB and bilateral donors have supported trade policy reform in varied ways.	<ul style="list-style-type: none"> • Allows all enterprises to exporting goods/ services in within the registered business scope without having to apply for export or import licenses. • No. of private SMEs allowed to export directly increased from 500 in 1998 to 4,500 in mid 1999. • Customs procedures have been streamlined. 	<ul style="list-style-type: none"> • Export market information is limited. • SOEs often have preferential access to market information. • Complicated custom procedures remain a "non-tariff" barrier with greatest impact on small volume exporters.

Major Reform (Policy Regulatory Decision: Number and date)	Major Domestic Agencies Involved	ODA Support provided	Outcomes	Outstanding Issues
Competition Policy and intellectual property				
Civil and Commercial Codes	National Assembly Ministry of Trade	UN agencies, WB and bilateral agencies have all provide support.	<ul style="list-style-type: none"> Provides some guidelines on competition issues and on protection of intellectual property 	<ul style="list-style-type: none"> State sponsored monopolies restrict private sector participation in a few sectors, but also increase cost structures for most other sectors Intellectual property protection is weak.
Taxation				
Value Added Tax Law (1999)	National Assembly MOF	IMF, WB, Canada, France, Germany and Sweden.	<ul style="list-style-type: none"> A new tax system is introduced to avoid the overlapped taxation. Reduction of tax fraud, making the taxation system more transparent. 	<ul style="list-style-type: none"> Too many VAT rates (4) and too many exemptions (26). Tax refunds are time consuming. Some provisions are not clear, resulting in difficult implementation. Too many guideline circulars. Tax systems, regulations are too complicated. Changes in tax regulations are frequent and not predictable.
Corporate Income Tax Law (1999)	National Assembly Ministry of Finance	IMF, WB, Canada, France, Germany and Sweden.	<ul style="list-style-type: none"> More transparent corporate tax system helps to simplify compliance, increase collection and reduce fraud. 	<ul style="list-style-type: none"> Corporate tax rate is high (now 32%, plus supplementary tax in some sectors). Complex system of exemptions. Some legitimate expenses are not tax deductible due to complex reporting. Marketing expenses are capped at 5-7% of total costs.
Business transactions				
Ordinance on Economic Contract (1998) Commercial Code (1997)	Ministry of Trade	France, Sweden and UNDP.	<ul style="list-style-type: none"> Facilitated commercial transactions between enterprises. State officially protects the rights of different parties in a contract. 	<ul style="list-style-type: none"> Ordinance on economic contract needs revision to reflect current situation and difficult to enforce contracts. Criminalization of business failure and civil disputes is a concern to investors. Overlap and inconsistency between civil, economic, commercial contracts.

Major Reform (Policy Regulatory Decision: Number and date)	Major Domestic Agencies Involved	ODA Support provided	Outcomes	Outstanding Issues
D. OTHER				
<i>Social Insurance</i>				
Labor Law Revised Labor Law 2002	MOLISA	ILO and WB	<ul style="list-style-type: none"> • Legal framework for social insurance has been set up. • Employees working in enterprises feel more protected. • Reduced burden on government budget. 	<ul style="list-style-type: none"> • Social insurance premium payable by employers is 15% of total salary costs. This encourages fraud and non-compliance. • Cases of social insurance law violations have not been adequately dealt with, leading to disrespect of the law.
<i>Private Business Association</i>				
Draft decree on business associations is under preparation.	Committee of the Government for Organization and Personnel (CGOP), Ministry of Justice	ZDH DANIDA CIDA Asia Foundation	<ul style="list-style-type: none"> • Many business associations established. • Recently, there has been a rise in the number of "business clubs", "business association" and other business groups to represent particular sectors, issues or geographic region. 	<ul style="list-style-type: none"> • Some official business associations are dominated by SOEs. • Legal framework for the establishment of business associations is not clear. • Procedures for the establishment of a business association are complicated.