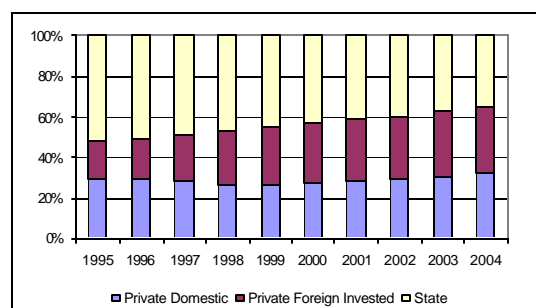


EXECUTIVE SUMMARY

A. Private Sector Characteristics and Government Policies

1. Viet Nam's private sector is rapidly expanding, and has outpaced the public sector by every measure over the past 10 years (output, investment, employment), buoyed by the expansion of international trade and tangible improvements to the investment climate. While the private sector now accounts for over 50% of GDP, 27% of total invested capital and more than 90% of the total workforce¹, it's potential for wealth creation is still largely undeveloped, as Viet Nam remains one of the lowest per capita income countries in SE Asia.² Viet Nam also maintains a large informal/shadow economy, which analysts estimate at between 16-50% of the formal economy³. If one were to add this informal GDP to the official figure, the percentage of total GDP generated by the private sector would be somewhere between 57-67%. Incentives to remain informal persist, from discriminatory tax rates and regulations to costly licensing and permit regimes in the formal sector.

Figure 1: Growth in Manufacturing Output 1995 - 2004



Source: World Bank, Vietnam: Investment Climate Assessment. Draft August 2005

2. The State intends to retain a significant role in the economy, not only through heavy regulation but also in the ownership and management of thousands of SOEs which compete directly with the private sector and generate an estimated 29% of GDP. SOEs enjoy preferred access to credit, land and markets which deters private enterprises from making the investments required to successfully compete against them. Opening up markets dominated by SOEs (including infrastructure) and improving competitive conditions throughout the economy is a major challenge for the government going forward.

3. The 2001–2010 Socio-economic Development Strategy (SEDS) 2001-2010, recently approved by the 9th Ninth Congress of the Communist Party of Viet Nam, recognizes the need for an evolving multisector economy that provides equal opportunities for the private sector, but at the same time reaffirms that the state will continue to play a leading role in strategic activities. While the concept of a “socialist-oriented market economy” referred to in the SEDS is not precisely defined, the authorities have indicated that they aim at creating an economically level playing field for private and foreign-invested enterprises, but envisage that state-owned enterprises (SOEs) and the state sector will continue to play a role in sectors where the Government feels that the conditions are not ripe for private sector activities, or where the private sector is not forthcoming.

¹ As cited in the Government Report presented by Standing Deputy Prime Minister Nguyen Tan Dung to the 7th Session of the 8th National Assemblée May 5, 2005 (reprinted in the Viet Nam Business Forum Report June 1, 2005, p115); these figures include both registered and a portion of unregistered enterprises as estimated by the GSO, which does not include all informal economic activity and therefore understates actual GDP (estimates of actual GDP vary from 116-150% of official GDP)

² IMF (2005) estimated GDP per capita at USD483 in 2003 and projected USD537 on 2004; ASEAN average was USD1266 in 2003; of the 10 ASEAN member countries, only Cambodia, Laos and Myanmar have lower GDP per capita rates than Viet Nam

³ According to the World Bank/IFC/MPDF Study “Informality and the Playing Field in Viet Nam’s Business Sector”, 2003, pg15, the share of the shadow economy in GDP increased from 30 percent in 1997 to 51 percent in 2001; informal GDP includes unreported revenues of both registered and unregistered firms

B. Private Sector Assessment: Key Findings

4. Viet Nam is in a rapid transition from a planned to a market economy, and many of the legal, regulatory and institutional mechanisms necessary for sustained private sector growth are still under development. While the country has demonstrated its global competitiveness in a number of export industries, and has made notable progress in introducing key legislation in support of private sector development, its overall business climate still ranks low in international rankings⁴, and serves as a drag on the development of higher value-added domestic industries.

2. The transition to a more open, market-based economy is a complex undertaking, made more so by the government's desire to maintain a large grouping of SOEs to coexist with the private sector. Viet Nam's private sector business climate remains riddled with obstacles to investment, most of which are centered on the limited access to key resources, the market protections and concessional resources given to SOEs (creating an uneven playing field), the intrusive bureaucracy charged with implementing the legal and regulatory framework for doing business, the complex nature of this legal and regulatory framework, and the absence of reliable mechanisms for the resolution of commercial disputes. Together, these constraints create incentives for the private sector to operate informally, avoiding as many regulations as possible and in the process placing themselves outside the formal credit and business networks. In summary:

- *Limited access to credit and capital.* Private enterprises continue to find it difficult to borrow from the commercial banking sector, and the relative underdevelopment of the financial sector makes few other sources of finance available. Bank credit is restricted by weak credit evaluation systems and creditor rights regimes, onerous collateral requirements and a general crowding out by SOEs who benefit from implicit government guarantees, making them better credit risks.
- *Limited access to suitable land/business premises.* The shortage of suitable industrial land and absence of a formal land market present considerable challenges to private enterprises. Moreover, existing titling systems and regulations make it difficult for enterprises with leased facilities to fully utilize these assets to mobilize additional business investment
- *Limited access to information.* Information regarding market structures, suppliers, customers, public procurement contracts, planned public investment programs and regulatory changes is not readily available in Viet Nam, leaving companies to either expend valuable time researching it or simply operate without. In the absence of this information, businesses find it very difficult to identify new market opportunities or make significant investment decisions.
- *Lack of a level playing field.* SOEs continue to dominate the economy, benefiting from market protections and resources offered at concessional rates by the government (in particular finance and land). This shuts the private sector out of certain commercial sectors, and creates unfair competition in others. Continued subsidization of the SOE sector not only diverts government resources which might be otherwise channeled in support of PSD, but also restricts the competition which could stimulate innovation and value-creation for the Vietnamese consumer
- *Intrusive bureaucracy.* While results vary significantly from province to province, businesses often complain of the frequency of inspections, degree of discretion exercised

⁴ including the World Economic Forum's Global Competitiveness Report 2004/05 where it placed 79th out of 103 countries surveyed for "Quality of the National Business Environment", a 17 point decline over the previous year

in tax collection, and time spent dealing with the changing requirements of various licensing offices. The sheer success of some provincial governments in facilitating the regulatory compliance of its private sector point to the progress that can be made by their more intrusive peers.

- *Complex legal and regulatory framework for doing business.* The propensity of lawmakers in Viet Nam to want to prescribe all allowable activities in law leads to an extensive set of laws, decrees, ordinances and implementing regulations. At the same time, the efforts of the government to transition to a market economy have generated a host of new rules and regulations, many of which overlap and/or contradict the existing ones. The complexity of the framework at best creates delays in implementation, (as officials seek clarifications on the law), or at worst opportunities for unofficial payments (as officials use discretion in applying the law).
- *Absence of reliable dispute resolution mechanisms.* In Viet Nam, the effective absence of formal and reliable dispute resolution mechanisms raises the risks of doing business and leads most SMEs and foreign investors to limit contracting as much as possible, thereby restricting the development of domestic business networks.

5. Viet Nam also has considerable infrastructure development needs. The rapid pace of economic and population growth continues to put strains on existing infrastructure resources, making further investments critical. Investment requirements over the 2006-2010 period are estimated at between 6-15% of GDP, representing a 60% increase over average levels since 2000. The scale of these financial requirements is beyond the fiscal capacity of the Government, even with the expected contribution of increased user fees, equitization proceeds, new bond issues and ODA loans. The shortfall, which could be as much as \$2.5 billion per year, will need to be mobilized from the private sector in the form of viable public-private partnerships.

6. The Government's attitude towards private sector participation in infrastructure remains ambiguous, however, and only a handful of projects have been successfully completed to date. Low tariff levels, incomplete regulations, and "bundling" of sector utilities all contribute to reducing the potential for widespread private sector participation. During the next five years, gradual removal of these barriers should be accompanied by individual demonstration projects, and a gradual increase in private contractors' participation in public procurement.

C. Proposed Future ADB Private Sector Development Strategy

7. Based on the above analysis, five key goals can be identified to effectively support PSD in Viet Nam:

(i) Level the playing field. While the proposed UEL and CIL are designed to establish the legal and regulatory framework for equal treatment of all enterprises (public, private, foreign and domestic), and the new competition law should help to prevent anti-competitive behavior, a number of additional measures must be taken if the full benefits of these new laws are to be realized: (1) further corporatize and/or equitize SOEs so that an increasing number are covered by the UEL and CIL, (2) open up markets currently closed to PSP (e.g. infrastructure), (3) further reduce licensing requirements applicable only to FIEs, (4) improve private sector access to information on public investment plans and procurement opportunities.

(ii) Simplify the Regulatory Framework: (1) Eliminate conflicts and inconsistencies between proposed new UEL and CIL with related legislation and regulations, (2) rationalize the investment incentive framework, (3) clarify and align corporate income tax rules to internationally accepted principles, (4) prepare new regulatory frameworks to facilitate competition in the infrastructure sectors

(iii) Improve access to land and finance. This will require (1) support for the implementation of Land Law reforms, (2) creation of LURCs for SOE land holdings and inclusion of these into the new land market, (3) strengthening credit evaluation skills within the banking sector, (4) strengthening the creditor rights regime, (4) ensuring that SOCBs operate under hard budget constraints, (5) improving disclosure standards among private enterprises and (6) pursuing the development of the non-banking financial sector to provide increased access to leasing and capital markets.

(iv) Strengthen the framework for business contracting and dispute resolution. With the promulgation of the new Civil Code and Civil Procedures Code, contract law and its implementation have been clarified. Further progress will now be required in ensuring that judgments and arbitration awards can be enforced, with the promulgation of a new Law on the Enforcement of Judgments and a strengthening of the technical capabilities of the Enforcement Agency.

(v) Support the creation of pro-private sector business environments at the local level. Local governments have a significant impact on the business conditions in their constituencies, as has been demonstrated by PCI and numerous subnational surveys. Demonstrated best practices of those provinces with the highest business climate ratings should serve as a models for replication throughout Viet Nam.

8. While it is recognized that a necessary element to achieving these goals will be the continued strengthening of Viet Nam's public administration, with the increased transparency, accountability and efficiency necessary to channel state resources in support of private sector development, a detailed discussion of these needs is not included in this analysis, for reasons of scope. It should be noted however that ADB's continued support of the Government's Public Administration Reform with a cluster program loan is helping the Government to more effectively service the needs of the private sector. Further examples of mechanisms by which some subnational administrations have improved governance and created pro-private sector conditions are included in section III. A. 2 above .

9. The donor community is active in addressing some aspect of each of the five major PSD goals listed above. Gaps exist, however, and these should be an important determinant in selecting ADB's PSD interventions, along with ADB's available resources and opportunities to leverage ongoing programs and core capabilities. ADB's ongoing programs in diversifying the financial sector, improving the legal and regulatory environment for SMEs, facilitating access to finance and land through improved accounting standards, immovable and movable asset registration, expanding access to international markets through improved technical standards and creating opportunities for increased private sector participation in infrastructure sectors all respond to critical needs for private sector development. **Over the next 5 years (through 2010), it is proposed that ADB continue its efforts in the financial sector, as is proposed with the FSDP III, pursue the implementation of the reforms begun under the SME Development Program, support legal and regulatory reforms in the infrastructure sector to facilitate private sector participation, and consider technical support to the government to prepare a pipeline of public-private partnership opportunities in infrastructure.**

10. This proposed program mix would allow ADB to continue to address 3 of the 5 major PSD goals set out above (leveling the playing field, simplifying regulatory frameworks and improving access to land and finance), and is fully in line with the government's draft Five-Year Socio-Economic Development Plan 2006-2010, which emphasizes infrastructure development, expansion of the financial sector and continued improvement in the legal framework for private sector development.

11. Within this proposed overall approach, priorities can be specified in each of the ADB's three categories of interventions for PSD: creating enabling conditions; generating business

opportunities; and catalyzing private investment. These priorities are identified in Table 1 below. A broader Roadmap for Private Sector Development is included in Appendix IV, which places proposed ADB initiatives within the broader group of all reforms needed to support PSD in Viet Nam.

Table 1 – Strategic Thrusts for ADB support to PSD in Viet Nam

Creating Enabling Conditions	Generating Business Opportunities	Catalyzing Private Investment
<p>Develop financial intermediation of long-term funding, in particular via insurance and pension products</p> <p>Continue to support key reforms under SME Development Program including the overall legal and regulatory framework, licensing reform, business registration, access to finance and land.</p> <p>Strengthen the policy, legal and planning framework for PSP in infrastructure, including the development of standard contracting modalities</p> <p>In the power sector, support the government in implementing the new Electricity Law, including determining appropriate mechanisms for attracting PSP during the transition</p> <p>In the transport sector, support the government in defining future sector structures for ports, airports and roads and corresponding PSP modalities</p>	<p>Create opportunities for public-private partnerships in infrastructure through the creation of project development facilities</p> <p>Improve access of private companies to public procurement contracts through (1) improved dissemination of information on procurement opportunities and (2) revised tendering procedures</p>	<p>Demonstration projects for private participation in infrastructure or infrastructure services</p> <p>Funds or other financial instruments to develop domestic private firms' access to long term funding, including in local currency</p>