

SUMMARY PROGRAM IMPACT ASSESSMENT

1. This annex presents a brief Program Impact Assessment (PIA) for the Second Small and Medium-Sized Enterprises Development Program. In line with best international practices and prior PIAs, this section applies a four-step methodology to evaluate costs and benefits of the proposed program, including: (i) the definition of the problem; (ii) the definition of the impact and outcomes of the proposed program; (iii) a range of options considered for achieving the defined impacts and outcomes; and (iv) the assessment of costs and benefits.

A. Definition of the Problem

2. Despite substantial improvements over the last decade, a somewhat vague and inconsistent regulatory framework for private sector activities hampers in Viet Nam the development of local small and medium enterprises (SME), placing a critical constraint on employment generation. As a result, income-based poverty reduction national goals and strategies are compromised. A flourishing SME sector will prove instrumental to support the demands for jobs of the estimated 1.7 million young workers joining the labor market annually.

3. Current enterprise density levels in Viet Nam are low, with merely 15 enterprises per 10,000 people, as compared to 137 in Thailand. In addition, the average firm size seems to have declined steadily since 2005 according to longitudinal government surveys.¹ This decline may signal potential losses of productivity due to absence of economies of scale, and could be reflective of the challenges encountered by domestic companies to increase their activity levels.

4. Among these challenges, access to finance is a major constraint for 45% of small firms according to a World Bank recent survey, a percentage significantly higher than for smaller enterprises. Although progress has been achieved in improving SMEs' access to finance in the last 5 years, a number of surveys still find that access to finance remains the top constraint for business growth. This is partly explained by the large increase in new enterprises during this period, which increase competition for financial resources. The trend is likely to remain.

5. In the next 5 years, the government targets to double the number of new enterprises.² These new entrants face collateral and other traditional access constraints. In addition, existing enterprises are constrained by the lack of medium-term credit for investment and innovation. The CIEM-ILSSA survey finds that more than 65% of enterprises in the manufacturing sector depend on retained earnings to support their investment. The heavy reliance on self-financing for investment can partly explain the relatively slow graduation of enterprises from micro to small and from small to medium size.

6. In contrast with Viet Nam's remarkable achievements in streamlining business registration since the implementation of the Enterprise Law in 2000, progress in other areas of the business regulatory framework is more uneven. Unclear assignment of responsibilities among the different levels of administration render overlapping and inconsistent regulations in critical areas such as land use rights, tax compliance, and customs administration. A major consequence of an inconsistent set of business regulations is that competition among economic players is negatively affected. If entrepreneurs perceive that regulations can be interpreted or applied in arbitrary ways, it may affect their willingness to initiate or further invest in the development of ventures.

¹ CIEM-ILSSA Survey (2007)

² Based on the draft Social and Economic Development Plan 2011–2015 being finalized by the government.

7. SME' preferences for priority reforms include: improved access to credit, assistance in the process of obtaining premises and land, and overall improvements in private sector regulatory policy. The latter involves, importantly, the removal of excessive and inconsistent bureaucratic requirements for businesses across the board. In response to these challenges. The proposed SME Development Program will support government's efforts in: (i) improving the regulatory framework for SME development; (ii) strengthen the framework for competition policy, and (iii) enhance SME access to finance.

B. Impact and Outcome

8. The impact of the Second SME Development Program is to increase the contribution of SMEs and the private sector in achieving sustainable high economic growth. The Program is expected to assist the doubling of newly registered enterprises, and to support a 10 percentage points increase in the share of employment in SMEs and private sector by 2015. In addition, the program aims to prompt: (i) improvements in the share of public sector investment (out of gross investment); and (ii) reductions in the cost of starting a business.

9. By assisting the development of a consistent regulatory framework, the outcome of the program will be an improved business environment to support more competitive SMEs and the private sector. An expanding SME sector will generate more and higher value-added jobs, and contribute to sustainable poverty reduction.

C. Options to address the problem

10. The proposed Second SME Development Program incorporates a multi-faceted approach to address the identified constraints to private enterprise development in Viet Nam. Firstly, the program promotes sound SME policy formulation and coordination. This includes support to the publication of policy papers on SME development; to the drafting of Government Decrees on support policies for SMEs; and to the development of databases that can anchor future policy formulation.

11. Secondly, the program assists the strengthening of the framework for Competition Policy. One part of the strategy is to enhance implementation of the Competition Policy Law and to strengthen the capacity of the Viet Nam Competition Administration Department to ensure fair competition among all economic players. A bigger part of the strategy is to implement broader competition policy by improving the business regulatory environment. These efforts include continuing administrative simplification, keeping close control of the promulgation of new regulations, and implementing regulatory impact assessments for all new regulations. Upgrading labor market regulations and labor relations will be an important part of efforts to improve the business environment.

12. Lastly, the Program supports Government policies aimed at improving SME access to finance by facilitating SME access to commercial bank lending and to alternative financial services. The program support extends to the establishment of a credit guarantee scheme for SMEs, and to improved access to equity finance and corporate governance practices by larger SOEs.

D. Impact Analysis

1. Dynamic Versus Static Assessment

13. The impact of the set of reforms supported under the proposed Second SME Development Program is likely to extend over several years. In our analysis, we are necessarily limited to the consideration of static costs and benefits. A dynamic examination of the impact of the regulatory changes proposed would require forecasting the levels of a wide range of variables over the medium to long term, and then estimating the expected costs and benefits of the set of reforms proposed, based on the evolution of such variables over time. Ultimately, the removal of regulatory barriers to enterprise creation and development would render economy-wide benefits in the form of improved competitiveness of local firms in the domestic and international arena, sustainable job creation, and increased participation of the domestic private sector in Viet Nam's GDP.

14. This dynamic analysis is however outside the scope of this assessment. Our focus is on the static net gains derived from the reforms proposed. A static impact analysis of the program offers important insights on the expected gains derived from reforms should critical economic indicators remain at current levels. Even under these somewhat limiting assumptions, the implementation of the package of reforms may usher very sizeable net benefits.

2. Benefits Estimation

15. The comparative performance of provinces in Viet Nam is testimony of how improvements in governance are significantly related to economic performance. Viet Nam's latest Provincial Competitiveness Report shows that a one-point increase in the Provincial Competitiveness Index (PCI) score (with a range from 0 to 100) is associated with a 6.9% increase in active private companies, a 2.6% increase in average investment per capita, and a 1.6 percent increase in GDP per capita in the subsequent year. The composite PCI captures ten critical dimensions of provincial competitiveness, including aspects that are central to the program of reforms proposed, such as regulatory compliance, competition environment, land access and security or entry costs among others. The removal of regulatory inefficiencies at the national level is thus likely to render important net benefits in the form of economic growth from further private sector development and employment creation.

16. Regarding the specific impact of each proposed output, improved policy/planning framework for SME development initiatives will contribute to overall policy improvement and allocative efficiency. An important implication of a consistent and streamlined regulatory framework for SME development is that it may assist overall resource allocation in the economy. If it is perceived that the cost of doing business is reduced, and that the legal protection enjoyed by domestic entrepreneurs is adequate, then increased investment in private sector ventures is likely to follow. This would imply the re-allocation of perhaps originally idle financial and human resources into productive activities in search for higher rents. As a result, economy-wide efficiency is surely enhanced despite the difficulties encountered in estimating such an effect in GDP growth for instance. The program also supports government efforts to assist the development of female-led enterprises, potentially incorporating new female entrepreneurs to the market (with their associated resources) and increasing competition. Between 2007 and 2009, the share of loan applications from women-led SMEs increased from 32% to 34% of the total.

17. Support to the new national web-based business registration system, apart from the expected gain in administrative simplification, will have an important impact on access to finance. The new Credit Guarantee Scheme (CGS) for SMEs requires firms to be formalized (registered) in order to have access to this service. In 2009, the CGS guaranteed about D12 trillion SME credit and it is reasonable to expect it to grow by 20% to 30% within the next 5

years. The implementation of the Credit Guarantee Scheme for SME is expected to reduce the net cost of medium-term lending by 1 to 1.5 percentage points.

18. Support to the development of a more flexible interest rate environment will assist loan negotiations between credit institutions and SMEs. This additional flexibility is expected to have a positive impact on overall access to finance and on sustained increases in overall credit levels to SMEs. The “formalization” of SMEs also means that they receive their value added tax (VAT) books and therefore overall tax collection may increase with the expansion of the tax base.

19. The simplification of administrative procedures included in the program, and in particular, of 258 procedures in the area of tax, custom, land and real estate sectors could save business up to D6 trillion (\$300 million) annually in compliance and administrative costs, translating into increased levels of self-investment and assisting job creation. The potential impact of simplified customs policies can be amplified via the support the proposed program lends to the implementation of e-customs programs in 10 pilot provinces.

20. The implementation of regulatory impact assessment procedures will improve the quality of new regulations and increase the accountability of responsible officials by requesting them to assess the impact of the proposed reforms. It can also assist inter-agency cooperation and stakeholder participation as the preparation of impact assessments will require delving on the expertise of different organizations. Over the medium term, it will reduce uncertainties associated with inconsistent government regulations.

3. Cost Estimation

21. The implementation costs of the reforms supported under the proposed Program will be mostly borne by Government agencies and financial institutions. First, the development of SME White Papers, policy studies, and all government regulations and resolutions associated with the Program are likely to represent a cost of around \$7 million according to ADB estimates, including the costs related to the implementation and management of consultation mechanisms with relevant stakeholders.

22. New system development and software upgrades, including information websites, web-based business registration systems and e-customs programs are expected to cost in the vicinity of \$18 million.

23. The implementation of the Credit Guarantee Scheme (CGS) for SMEs, the legal protection program for SMEs, and the start-up cost of the unlisted public company market are estimated to cost \$45 million.

E. Program Financing

24. To support the reform initiatives outlined in the Program, the Government of Viet Nam has requested a loan in various currencies equivalent to SDR26,537,000 from ADB's Special Funds resources to help finance the program. The size of the loan for the first subprogram is based on considerations of several factors required to support implementation of program reforms.³ These include: (i) the importance of the sector to the economy, the weight and benefits of the reform program; (ii) the direct administrative and/or adjustment costs involved in design

³ ADB. 2010. Program Lending. *Operations Manual*. OM D4/BP. Manila (para. 28).

and implementation of specific reforms, and (iii) the need to conform to the overall financing requirement for the current country partnership strategy.