

## **The dynamics of Vietnam's business environment: Complying with obligations abroad and competing at home**

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### **Top-down and bottom-up in business environment reforms**

An economy's business environment is not defined by just the legal and regulatory framework at the national level. Local governments typically play a major role in shaping the actual business climate, both through their own regulatory action, and through their implementation of national-level regulations. While no change in the national framework can happen without central leadership and commitment, the impetus for reform may also come from below.<sup>1</sup> And the reverse is also true: without adequate implementation at the local level, national reforms can fail to have an impact on competitiveness and economic growth. Strategies linking top-down and bottom-up reforms are therefore critical any successful initiatives to forge a business *enabling* environment.

Vietnam's success in connecting these two dimensions— promoting national-level reforms and stimulating a competition for improving the business environment at the local level—offers a number of lessons. USAID projects have played a major role in these efforts. The Support for Trade Acceleration Project (STAR I and II), focusing on the implementation of the US-Vietnam Bilateral Trade Agreement and WTO accession, and the Vietnam Competitiveness Initiative (VNCI I and II) have supported regulatory and administrative reforms by the country's institutions at all levels. One element of that support has been the introduction of the Provincial Competitiveness Index (PCI) as a yardstick for changes in the provinces' business environment. The Spring 2006 issue of *Developing Alternatives (Breaking the rules that bind: Freeing private enterprises from the shackles of regulation)* reported on initial experiences with the PCI in assessing the impacts of local business environments and stimulating competition among provinces to improve key governance indicators. Since then, the VNCI Project has carried out annual PCI surveys that have become a major factor in promoting business environment reforms at the provincial level.

These local initiatives fit into and contributed to the broader context of legal and regulatory reforms at the national level. Over the last seven years, Vietnam has revamped much of its economic framework, largely in response to requirements to implement first the Bilateral Trade Agreement with the United States (BTA), and then similar but expanded requirements to accede to the World Trade Organization (WTO).

### **Trade obligations drive business environment reforms**

Most modern trade agreements—in particular US trade agreements and WTO and EU accession or treaties—entail extensive requirements that go far beyond the traditional objective of reducing barriers to trade, such as tariff rates and import quotas, calling for developing countries or transition economies to modernize their legal and institutional frameworks. To bring rules, regulations, and administrative procedures more in line with international best practices requires a commitment to legislative and regulatory transparency, due process, arms-length regulation applied equally to all firms, administrative review and formal dispute settlement through arbitration and the courts. Effectively employed, the increasingly

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<sup>1</sup> At times, of course, reforms may be triggered by concerns at the sectoral (or value chain) level, where the regulatory and administrative burden demonstrably and avoidably undermine competitiveness. See the article by Bryanna Millis in this volume.

transparent and legal representation of commercial, regulatory and administrative rights and responsibilities benefits both domestic and foreign firms. It improves the business environment, strengthens the rule of law, and combats corruption.

Regulatory reform through trade agreements is “top-down:” the national government negotiates with foreign countries to develop a trade treaty that is enacted into law for application throughout the economy. In some cases, needed legislation and regulatory reforms must be in place before negotiations are finalized. In other cases, a country promises to phase in reforms over a specified period of time. Either way, effective implementation of the reforms generally takes time as institutions need to be strengthened.

Trade agreements can provide developing countries with a useful road map for improving their economic competitiveness, as the economy faces increased foreign competition. Policy makers can use that road map to improve the business environment, and to exert pressure on both the executive and the judiciary to improve their regulatory and dispute resolution responsibilities. For example, trade agreements typically have strong transparency requirements—requiring that all laws and regulations be published in an accessible state journal before coming into effect, and that private stakeholders have the opportunity to be aware of and comment on the drafting of new laws, regulations, and administrative procedures. Transparent legislative, legal, regulatory and administrative systems are the cornerstone for strong economic governance and rule of law.<sup>2</sup> Transparency can facilitate bottom-up pressure for reforms by businesses and consumer groups. A more transparent legal system enables business groups to exercise their rights and counter arbitrary application of rules.

Expanding trade in services, and encouraging foreign investment in not only primary and manufacturing sectors, but also services, have emerged as key concerns. Improved access to services is a key factor in shaping an economy's competitiveness. Critical service sectors are often subject to the most stringent government regulations because of social and public policy concerns, typically restricting the role of foreign providers. Balancing the need to facilitate the provision of services throughout the economy with adequate safeguards for these concerns poses a serious policy challenge. Expanded trade in services broadens services available to business by opening access for foreign service providers and simulating the development of international standards among local service providers. Trade agreements provide guidelines for effective regulation to be applied equally and fairly among foreign and domestic firms with adequate opportunity for appeal.

Provisions to encourage and facilitate foreign investment include demands for streamlining the registration process for foreign firms. National treatment commitments in turn encourage partner countries to make registration easier for domestic firms. These efforts in turn can strengthen the corporate governance regime, to improve contract enforcement, modernize the financial sector, and enhance procedures to register and protect property rights. US trade agreements, in particular, also stress improving protection of intellectual property rights, which in turn have important requirements for improving judicial procedures.

### **Fostering national regulatory reforms**

In Vietnam, the USAID-funded STAR Project supports national-level reforms agreed to in the BTA, which became effective in December 2001. In January 2007, Vietnam acceded to the WTO. Both the BTA implementation and WTO accession guided a comprehensive process of review and revision of the country's system of commercial laws and judicial procedures, within the context of Vietnamese institu-

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<sup>2</sup> See also the articles by Delia Rodrigo and Jeffrey Lubbers in this volume.

### The Provincial Competitiveness Index (PCI)

Vietnam's Provincial Competitiveness Index (PCI) seeks to compare business environments across provinces, based on responses to a mail survey of businesses (in 2008, 7,820 firms returned the questionnaire, resulting in a response rate of 26 percent, up from 21 percent in 2007; actually, after correcting for firms that went out of business or moved, the response rate was over 30 percent), in combination with available statistics ("hard" data). The survey results and *hard data* are combined into ten subindices:

- (1) entry costs,
- (2) access to land,
- (3) transparency and access to information,
- (4) time costs of regulatory compliance,
- (5) informal charges,
- (6) state sector bias,
- (7) proactivity of provincial leadership,
- (8) private sector development policies,
- (9) labor training, and
- (10) legal institutions.

These subindices in turn are then aggregated into overall PCI using a procedure *that assigns weights* to each according to their importance in shaping economic performance (investments, profitability, and firm registrations), based on an econometric analysis. To compare provinces on an equal basis, the PCI controls for effects of structural endowments and conditions, such as market size, human and physical capital stocks, infrastructure, and location. Realizing that the rankings might be controversial, the project team paid particular attention to partnering with a strong local organization—the VCCI—and involving local economic research institutes as well as well-respected economists to develop the questionnaire and check the data.

Since 2006, the PCI has covered all 64 provinces, and the approach has remained stable—which allows for comparisons over time.

Vietnam is somewhat unique with respect to available economic data by region (province). Where such data are *not* available, the approach needs to be adjusted; in these cases, it may not always be possible to disentangle the effects of the business environment, as measured in the PCI, from other factors.

The PCI reports, as well as the survey data, are available at [www.pcivietnam.org](http://www.pcivietnam.org).

tions and traditions. Vietnam revised or developed anew more than 100 laws and regulations in this process. In fact, many of these reforms went far beyond the specific requirements in the trade agreements. Over the last ten years, Vietnam has shifted its development strategy solidly to promoting a competitive market economy.

In response, economic growth has been strong, as international and domestic trade and investment have boomed.<sup>3</sup> Poverty levels have fallen substantially. Greater integration into international markets, however, has raised new challenges. Vietnam has struggled to manage a major increase in capital inflows following WTO accession. Integration also means that the economy is more exposed to the current global financial crisis and economic downturn.

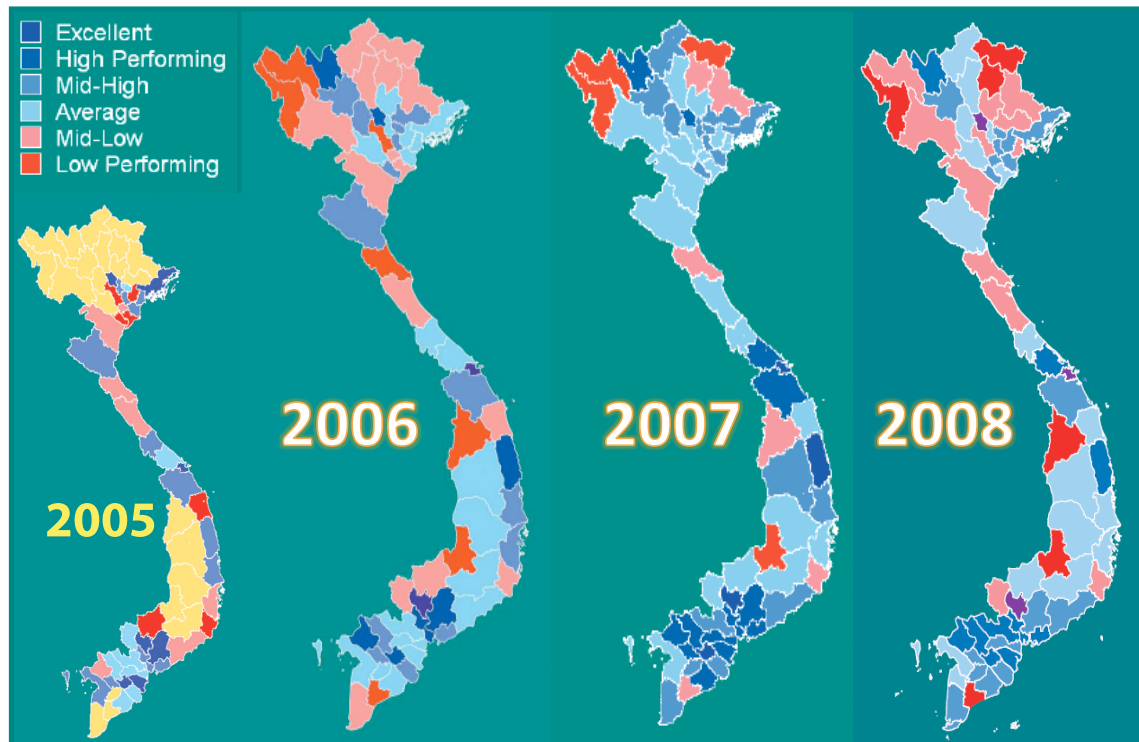
### Advancing bottom-up reforms

USAID's Vietnam Competitiveness Initiative (VNCI) in many respects complements support for national level reforms through the STAR Project. A central focus of this assistance is the Provincial Competitiveness Index. Launched in 2005, the PCI (see box for a brief description) seeks to foster competition among provinces in pursuit of a more hospitable business environment.

The first PCI report was published in 2005 by the Vietnam Chamber of Commerce and Industry (VCCI) and VNCI. That report was the first effort to document the importance of good local economic governance for economic growth and private sector development in Vietnam. It was the subject of immense attention from government officials, the public and media. This initial report, as well as subsequent PCI reports (2006, 2007, and 2008), demonstrated that there are important differences in how provincial government officials interact with and support local businesses, and how laws and regulations are being implemented at the provincial level. The PCI also revealed the considerable scope of provincial

<sup>3</sup> See Parker et al. (2005)

governments' discretionary authority. Vietnam is nominally a centrally dominated system, but provincial officials have considerable leverage in their implementation of general guidelines. The PCI substantiated a large variance in exercising this discretionary authority, and the impact of local choices for private sector success, suggesting a "governance premium:" provinces with higher PCI scores tend to have higher per capita incomes.



The PCI is a tool for measuring and assessing the standards of economic governance in Vietnam's 64 provinces. It incorporated some of the elements of the World Bank/IFC's *Doing Business* indicators, but focused primarily on the perspective of private domestic enterprise. The calculation of the PCI has benefited from the availability of detailed data at the provincial level in Vietnam. Its impact has been boosted by the enormous public response to the release of each annual PCI report. From the outset, the immense media attention to the PCI has been an important element of its success. The media have reported on provincial rankings and, in particular, responses—both positive and negative—to the PCI from local government officials.

The analysis of the PCI highlights the importance of good economic governance for attracting investment and generating growth, and identifies opportunities for better practices at the provincial level. The PCI methodology has proven to be remarkably robust, consistently identifying top performers among Vietnam's provinces, while allowing room for other provinces to improve and achieve higher PCI scores in subsequent years.

The PCI survey highlights common problems across provinces that *cannot* be resolved at the provincial level. Many of the regulatory requirements that businesses must comply with at the provincial level are imposed by national laws and regulations (laws, decrees, circular, decisions), as well as by the day-to-day application of those laws and regulations in the provinces. Action at the national level is necessary to over-

come these hurdles. Aggregate PCI data<sup>4</sup> show that the significant regulatory burden on businesses seriously impairs their ability to grow, add jobs, and access markets.

Overall, the PCI has gained a strong reputation as a reliable and accurate tool to assess economic governance. Central and local officials have “internalized” it as a reform tool to focus public consultation procedures, and to benchmark progress in economic governance.

### **Registering progress at the provincial level**

Since the release of the first report in 2005, the PCI rankings have encouraged competition among provinces to improve scores—in practice leading many provincial governments to launch initiatives to improve local economic governance. A number of provinces have climbed the “PCI ladder:” between 2006 and 2007, the median weighted PCI score rose from 52.4 to 55.6, reflecting gains in economic governance. In 2008, however, it actually dropped to 53.2. The principal causes: private-sector development services and labor policy—among the four most heavily weighted subindices—declined across most provinces, and public service delivery slipped in some provinces. The decline in 2008 may also reflect unmet expectations by firms; Vietnam’s has steadily improved its legal and regulatory framework which is raising the bar for the officials. Finally, national-level factors also played a role. Firm perceptions are also likely to be connected to macroeconomic instability and subsequent insecurity experienced by private actors at the beginning of 2008. Such changes are not unusual in surveys that reflect perceptions.

The subindex for the time costs of regulatory compliance has worsened over time, largely as a result of higher post-registration costs of regulatory compliance—23 percent of the firms report spending more than 10 percent of their time on bureaucratic procedures. The burden of government inspections, however, declined substantially to the point that they are no longer reported as a significant obstacle to doing business. In contrast, cumbersome paperwork and other procedures in day-to-day interactions with provincial bureaucrats continue to pose problems. In an effort to alleviate the regulatory compliance burden on businesses, the Prime Minister has launched a new program, *Project 30*, intended to streamline administrative procedures. STAR and VNCI are providing technical assistance and support to implement Project 30.

On the positive side, waiting periods for business registration and procedures for start-up have declined significantly throughout the country, largely attributable to the creation and operation of one-stop shops. Security of property rights also improved, with 81 percent of PCI respondents holding formal land use right certificates, up from 75 percent in 2007 and 55 percent in 2006. The survey also registered gains in transparency and access to legal documents, largely because of the growing importance of Provincial Gazettes mandated by the 2005 Law on Local Laws. A significant improvement in 2008 was a decline in state-sector bias, which reached a historical low. Only 39 percent of survey respondents reported explicit bias on behalf of state-owned enterprises (SOEs), and more than 50 percent of firms believe that their province has a positive attitude toward private entrepreneurs. In fact, the number of provincially-managed SOEs has fallen by 60 percent since 2000 largely because of equitization.<sup>5</sup>

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<sup>4</sup> To draw out implications of the PCI survey data for national policy, VNCI developed national aggregates from responses to individual questions in the survey, and weighted them by the provincial portion of the population. These findings were published at the June 2007 Vietnam Business Forum in a paper by Edmund Malesky and Helle Weeke.

<sup>5</sup> Official English translation of the phrase *co phan hoa*. It is the process by which shares of state-owned enterprises are offered to the public. Centrally managed SOEs, however, may have become more important; some of them are investing all over the country.

A number of provinces officially made legal commitments to improve PCI scores through official resolutions of the Party Secretary and People's Committee, or adoption of action plans sanctioned by the top leadership. In many cases, these documents go beyond broad statements that call for general improvements, and identify specific provincial weaknesses in economic governance, assign responsibility to individual actors, provide clear targets for measuring success, and identify local initiatives to help achieve those results. Tracking PCI scores over time has shown that the provinces that have achieved the greatest improvements are the ones where local leaders publicly committed to the task of improving scores.

Responding to requests from provincial leaders, the VNCI Project has conducted "PCI Diagnostics" in more than 40 provinces to identify possible improvements in economic governance practices. These diagnostics involve tailored presentations of PCI findings to provincial authorities, representing an exchange of ideas and not technical assistance per se. A number of these provinces have implemented reforms following the diagnostics, and have subsequently recorded gains in PCI scores. For the most part, however, these reforms have targeted "low-hanging fruit," such as making more legal and planning documents available on a provincial website, leading to modest gains in PCI scores. Some provinces decided to take the PCI Diagnostic approach further and requested longer-term technical assistance from VNCI; other donors as well, such as DANIDA, ILO, or SIDA, use the PCI in their own technical assistance programs with provincial authorities.

A highly positive trend is that provincial officials are also learning from each other. For example, officials from nearly every province in the country have traveled to Binh Duong, the perennial number one in the PCI rankings, to learn about best practices. One explanation for improvements and convergence among provinces in the Mekong delta has been their willingness to share reform initiatives through visits and consultations.

## **Reinforcing reforms at the national level**

### *Tackling the time-costs of regulatory compliance*

The Prime Minister's Master Plan on Administrative Procedures Simplification—Project 30—is designed to reduce the regulatory compliance burden. Implemented with USAID support through VNCI, it will initially inventory in a transparent, accessible, and comprehensive database all of the administrative procedures affecting firms at both the national and provincial levels. The inventory will allow for a rapid and thorough assessment of the current post-registration regulatory burden faced by firms, and will enable firms to reach a better understanding of their rights and obligations. The second phase of Project 30 will review, simplify, or abolish unnecessary, illegal, and cumbersome procedures.

Any achievements by Project 30 can be tracked directly by the PCI subindices of entry costs, land access, transparency of information, time costs of regulatory compliance, and informal charges. Provinces that are diligent in carrying out the inventory and review of administrative procedures in order to cut and simplify the cumbersome paperwork for firms should expect to attain higher PCI scores on key indicators. National median PCI scores should also improve, reflecting nationwide reductions in the regulatory burden..

### *Raising transparency*

The most critical factor in improving the local business environment is the transparency of business information. Statistical analysis suggests that firms tend to expand investment most rapidly when operating in provinces where regulatory information, master plans, and infrastructure maps are most widely available. New legislation targets transparency at both the national and provincial levels. The 2002 Law on the

Promulgation of Legal Normative Documents (LNDs)—the Law on Laws—requires publication of all national level legal documents for 15 days in the Official Gazette before coming into legal effect; revisions in 2008 establish a 60-day public comment periods for LNDs. The 2005 Law on Local Laws requires the establishment of Provincial Official Gazettes. These reforms, supported by the STAR Project, in part were designed to meet BTA and WTO obligations, but also serve to improve transparency and participation for Vietnamese businesses and citizens.

Publication of the Provincial Gazettes, mandated by the Law on Local Laws, proceeded slowly at first. In April 2006, only nine provinces and national-level cities published Provincial Gazettes. By June 2008, however, all but one province issued Provincial Official Gazettes in hard copy, and 20 provinces had set up searchable, online gazettes. The mere act of putting gazettes online had a dramatic impact on PCI transparency scores.

### *Addressing the implementation gap*

In 2005, Vietnam adopted two critical new laws: the Enterprise Law, which replaced the ground-breaking 2000 Enterprise Law that greatly facilitated business registration, and the Investment Law, which adopted a uniform set of rules for investment by all businesses, domestic, foreign or state. The Investment Law vested authority to issue most investment licenses in provincial Departments of Planning and Investment, a significant departure from prior rules, which had required investors to submit applications for investment licenses with the Ministry headquarters in Hanoi.

Once implementing regulations were issued, it quickly became clear that execution of these two new laws varied greatly among provinces. To help address the gap in the implementation, as well as other legal documents regulating the business environment, the government included the VCCI on relevant drafting committees. The VCCI also aggressively engaged in a dialogue with provincial authorities to improve implementation.

### *Setting up one-stop shops*

Vietnam's one-stop shops are intended to handle in one office three separate start-up procedures from three different government agencies: the business registration certificate issued by the local Department of Planning and Investment; the tax code issued by the tax authority; and the Seal for stamping documents—the “*chop*”—issued by the local police department. When one-stop shops for business registration were initially contemplated in the early 2000s, provincial governments were officially obligated to develop new procedures. Guidance from the Ministry of Planning and Investment specifies a maximum waiting period of 15 days for all three procedures.

Localities interpreted these policies differently. Some provinces granted official approval to have the *chop* made, but still required entrepreneurs to visit provincial police departments to register it after it was manufactured. Others required that a police official work directly in the one-stop shop, so that the *chop* registration could be granted immediately. Some provinces required separate applications for each document, while others found ways to consolidate the applications.

Eventually, in December 2007, the varying interpretations of the procedures for chop issuance led central officials to take action. The *chop* license was abolished by the Ministry of Public Security entirely. Now, a firm must only have its *chop* made at a local establishment and take it to the police for registration, a formality that cannot take longer than two days. With abolishment of this license, new guidance stipulated a maximum waiting period of no more than five days for registration and tax certificates.

## **Linking bottom-up and top-down for effective reforms**

Combining trade obligations and competition among provinces has led, and is continuing to lead, to an improved business environment in Vietnam. As a “living yardstick,” PCI-based monitoring establishes benchmarks and tracks progress. The PCI is being used as a monitoring tool by Vietnamese authorities and various donors to trace improvements in the business environment in provinces where they work. The US Mission uses PCI data as a basis for discussions with provincial leaders and businesses to understand the local business climate and evolutions in economic governance.

Vietnam has astutely combined top-down and bottom-up approaches to regulatory reform. Meeting trade obligations helped to create a more consistent, open and effective legal environment for business activity. The PCI has provided provincial governments and business stakeholders with a quantitative assessment of problems faced by private businesses at the local level. what policies can be changed to reduce those problems. It has also stimulated improvements in local economic governance through competition among provincial governments. USAID has worked in a highly effective partnership with Vietnamese government authorities and private-sector stakeholders at both the national and local levels. The ultimate beneficiaries have been more productive businesses, workers and farmers in Vietnam, creating jobs, growing incomes, and reducing poverty. The lessons learned apply more broadly.

## **References**

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