

# IMPLICATIONS OF THE PCI SURVEY FOR NATIONAL POLICY:

## Business Requirements for Regulatory and Legal Reform to Improve Competitiveness in The Post-WTO Environment

**By the Vietnam Competitiveness Initiative<sup>1</sup>  
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### **I. EXECUTIVE SUMMARY**

This “national” analysis of the Provincial Competitiveness Index (PCI) survey data is intended to assist national policy makers and private sector leaders in their continuing collaboration to improve economic governance and business competitiveness across all provinces. This discussion paper is intended to support the economic competitiveness dialogue at the national level by showing the critical linkages between provincial and national economic reform initiatives to create a dynamic competitiveness enabling environment. This paper invites all business and government stakeholders to contribute to creating a national focus on competitiveness by providing ideas, feedback, and counsel to the Vietnam Competitiveness Initiative (VNCI).

The PCI was developed and published by VNCI and VCCI in 2005 and 2006 to assess and rank provincial governments by their performance in economic governance for business development, while controlling for differences in their initial endowments. The 2006 PCI includes all 64 provinces and is based on responses from 6,379 Vietnamese enterprises.

The PCI survey data presents compelling evidence that provinces are facing some common problems in economic governance that cannot be resolved at the provincial level. Action at the national level is necessary to overcome these hurdles. The key finding from the aggregated data<sup>2</sup> is that the significant regulatory burden on businesses seriously impairs their ability to grow, add jobs, and access markets. The regulatory requirements that businesses must comply with at the provincial level are imposed by national laws and regulations (laws, decrees, circular, decisions), and by the day-to-day application of those laws and regulations in the provinces.

Initial recommendations for creating a national legal and regulatory framework to improve economic governance and competitiveness across all provinces include:

- **Implement regulatory reform:** within the framework of the Master Plan on Simplification of Procedures in State Management, undertake a broad, decisive regulatory reform within one year to simplify and streamline administrative procedures, formalities, and business requirements to create a low cost, low risk business environment to attract investment and encourage domestic entrepreneurship. The high costs and risks of burdensome regulations encourages a large informal sector and weakens Vietnam’s enterprises in an increasingly cost competitive WTO economy.

Simplification can be achieved within one year through a tool called the Regulatory Guillotine™<sup>3</sup> to increase transparency and eliminate administrative discretion in the application of procedures and requirements.

- **Introduce Regulatory Impact Assessment (RIA):** In an amended Law on Promulgation of Legal Documents, require RIA so that economic cost/benefit and effectiveness analysis is applied to new laws and legal normative documents related to economic and business activities. This initiative can be applied on a pilot basis in the short term and begin the process of building capacity within line ministries and at the center of government to oversee a modern system of policy-making.
- **Support revenue-backed bonds:** Create the legal framework to support revenue-backed bonds so that provinces can effectively finance over \$100 billion in infrastructure and related services required to support economic growth. Several pilot transactions for revenue-backed bonds can be undertaken immediately in Ho Chi Minh City and Hanoi while legal reforms are undertaken simultaneously. Vietnam cannot afford to delay major infrastructure upgrades to support rapid growth in a highly competitive WTO economy.
- **Strengthen key laws to support investment and enterprise growth:** Adoption of several key laws, such as an Administrative Procedures Law to improve the quality and fairness of basic administrative decision-making and new Law on Complaints that further improves the handling of complaints about administrative actions and decisions, and on bankruptcy and mergers and acquisitions are essential to allow Vietnamese enterprises to operate in an increasingly competitive global economy.

The implementation of these and future proposed reforms will help all provinces continue to embrace market, business, and investment-oriented reforms.

## II. DISCUSSION

The development of the Vietnamese economy in the years since the 1999 Enterprise Law has been remarkable. This Law and its implementing sub-laws reduced and simplified the number of administrative procedures, permits, licenses, requirements, etc., with which enterprises had to comply. In this regard, as well as in many other ways, the 1999 Enterprise Law was a great success. Despite the improvements in administrative procedures for enterprises, there is now a general consensus that the number of procedures, permits (especially baby permits), licenses, requirements, etc., that business must comply with is excessive and has increased over the last two to three years. New laws, decrees, circulars and decisions too often include additional, often duplicative and unnecessary, regulatory burdens on enterprises. The implementation of the new Law on Enterprises and the Law on Investment, both issued in 2005, did not effectively resolve this problem.

While there is today a general consensus that some form of administrative/regulatory reform<sup>4</sup> is necessary for Vietnam to stay competitive in the WTO environment, no clear, comprehensive strategy has yet emerged for how to achieve these objectives. Moreover, the debate about the

need for such administrative reforms has, to date, lacked a data-based foundation that lends support to these reform efforts.

The aggregated PCI survey data clearly support the need for reform and simplification of procedures and requirements that are imposed on enterprises. The survey data support specific on-going government initiatives, including the Master Plan, as well as the overall public administration reform initiatives of the Government. While the non-state sector business environment has improved a great deal, there is still much work to do, as demonstrated by the following highlights of the nationally aggregated PCI provincial survey data.

## A. Positive Developments

### *1. Reduction in Entry Costs*

The data demonstrates that regulatory entry costs for non-state enterprises have been reduced and no longer pose a severe obstacle to entrepreneurs with good business ideas. Only a handful of entrepreneurs (17%) report difficulties in completing the formalization process and only 6.8% of enterprises needed over three months to complete all the official activities necessary to start their business.<sup>5</sup> Moreover, the average enterprise requires only about 3.3 formal documents (certificates, stamps, licenses), before they can legally operate.

### *2. Fewer Inspections*

Similarly, there have been marked improvements to the amount of time required to conform to post-entry regulations. The median number of regulatory inspections a Vietnamese enterprise experiences per year is just one. Even more impressive, median inspections never exceed two in any single province and a full 48% of enterprises report that inspections have declined since the passage of the 2000 Enterprise Law. Similarly, only 18.5% of enterprises report that they spend 10% of their week or more dealing with bureaucracy or complying with bureaucratic rules.<sup>6 7</sup>

### *3. Improvement in Official Attitudes Toward Business*

In addition, nearly 70% of enterprises report improvements in official attitudes toward the non-state sector since 2000.<sup>8</sup> This is not surprising in light of the corresponding improvements noted in items 1 and 2 above.

## B. Remaining Challenges

### *1. Transparency and Access to Information*

The aggregated PCI data demonstrate that transparency and (equal) access to information still are major obstacles to enterprises. While a few provinces have improved business information access through their websites and DPI offices, many provinces lag behind. For instance, only 26% of enterprises in the sample believe they can easily access Provincial Master Plans; only 29% believe that yearly planning documents are readily available; and a paltry 18% believe they could easily access provincial infrastructure planning. The result is that the vast majority of Vietnamese enterprises are left with insufficient information to adequately assess their business risks and costs, as well as their opportunities. How can an enterprise possibly make a sound decision on expansion when it does not have reliable information about where new roads

will be built or which agricultural land will be converted to manufacturing usage? Some provinces such as Vinh Phuc, are showing the way by spending a significant amount of effort in providing helpful documents for businesses on their websites. Ho Chi Minh City, for example, publishes its urban development plans on its website, along with necessary documents for business registration. But as the above figures demonstrate, most other provinces remain non-transparent.

Another key area of information required by enterprises to make rational business decisions are proposed or already adopted changes in local and national laws, regulations and procedures. Here, provision of information by provincial and local authorities is insufficient as well. Only 6.6% of enterprises believe they can predict when central laws will be implemented in their provinces and only 7% believe the provincial government adequately discusses changes in national policies. Regular meetings with businesses could help improve the communication channel and provide local government with the information to simplify and improve administrative procedures to limit discretion in the application of laws. In contrast with the general lack of transparency in most provinces and localities, a few provinces such as Ho Chi Minh City and Dong Nai, are making progress in this area by having “Questions and Answers” sections in local newspapers and provincial websites to solicit and address the concerns and questions of businesses.

Significantly and unfortunately, the data appears to show that a group of non-state enterprises able to use personal connections to obtain access to critical business information is emerging. More than half the enterprises say that relationships are necessary for accessing regulatory information (56%) and claim that family and friends are vital for negotiating with provincial governments (57%). When a group of entrepreneurs benefit because of their “insider” connections rather than business acumen it does not bode well for future broad based economic growth. To prevent this, Vietnamese authorities at all levels must provide equal information access to all entrepreneurs, allowing the cream of the business sector to rise to the top, rather than the scum.

## *2. Legal Framework Needed to Facilitate Provincial and Local Government Finances*

Even with good and transparent master plans, provincial governments will have difficulty delivering improved infrastructure and related services to enterprises due to a shortage of financing. Modern infrastructure is essential to attract investment and sustain growth and higher productivity levels. The largest provinces, such as Ho Chi Minh City and Hanoi, already have difficulty financing an estimated \$24 billion and \$6 billion, respectively, in infrastructure requirements in their master plans, including new roads, bridges, power plants, ports, water and sanitation facilities and other infrastructure to support increased investment and growth. Provincial governments will not be able to finance over \$100 billion in infrastructure requirements through the state budget, overseas development assistance, or central-level general obligation bonds, which are currently the only sources of public finance.

National policymakers can play an important role in revising current laws to allow revenue-backed bond issuances through the Hanoi Securities Trading Center (HASTC) to leverage domestic and international capital markets to finance infrastructure in the provinces. Pooled revenue bonds can allow poorer and more remote provinces to finance much needed

infrastructure to attract non-state investment in manufacturing, agriculture, tourism and other labor-intensive services industries to ensure equitable growth in all regions of the country.

### *3. Dispute Resolution*

The aggregated data also establishes that there is a severe lack of confidence in the courts as a mechanism for dispute resolution. Only 20% of Vietnamese enterprises list courts as their first, second, or third preferred mode of resolving disputes with other businesses or local government agencies, while only 1.6% of entrepreneurs see the courts as their primary option. Looking past enterprise perceptions to actual enterprise behavior, non-state individuals and enterprises filed only 1,170 cases in all 64 Provincial People's Economic Courts in 2006, a staggeringly small number given the number of Vietnamese enterprises and the size of the population.<sup>9</sup>

This apparent lack of credibility of the court system is a critical weakness for the Vietnamese economy as the country moves forward on two reform fronts. First, increasing global integration (exemplified by WTO membership) will bring Vietnamese enterprises into business relationships with an increasing array of actors, whom they do not know personally. They, therefore, will likely be far less able to use social networks to enforce contracts and settle disputes, as they apparently now do. Fair and timely legal dispute resolution will become increasingly necessary for adjudicating far-flung contract disputes. Second, the innovation of the 1999 Enterprise Law was that it move Vietnam from a permission-based certification system to a simple registration/regulatory system. Entrepreneurs no longer needed permission to do business; they simply needed to formalize their activities so they could be properly regulated by local agencies. In a regulatory system, courts are critical, because they provide a key means for non-state enterprises to appeal the decisions of central and local regulatory agencies. As a result of these two trends, courts must be strengthened and judges better trained to increase the capacity of the courts to handle disputes -- including reviewing administrative actions and decisions -- and improve the perception of the courts as a credible institution. At the same time, commercial arbitration should be promoted as a tool to resolve business disputes among commercial partners. Hereto, however, credible and effective courts are essential to an effective system of arbitration.

### *4. Land Issues*

Although the PCI survey data include reports of increased access to land, and a reduction in the number of days it takes to get land use right certificates (LURCs) and negotiate with original holders, there are still problems in this area. The average is still 143 days to get LURCs and 125 days to complete negotiations. Moreover, 65% of enterprises still report that lack of access to land constrains their ability to expand business operations. While this was a 6% improvement over a similar weighted sample from 2005, it demonstrates that land continues to be an important obstacle to non-state sector growth. Finally, and maybe most disturbing of all, 51% of enterprises rate the possibility of expropriation of their land as high or very high, indicting that while land access has improved, the security of tenure rights has not kept pace.

The PCI survey data demonstrate that further reforms to increase land access for enterprises, as well as to improve the security of land tenure, should be addressed to allow for further non-state sector growth. In addition, the role of the state in land access should be reconsidered to

support the development of a modern, well-functioning real estate market that ensures access to land for new enterprises and existing enterprises seeking to expand their operations, as well as strengthening the legal framework for enforcement of contracts rights involving land.

### III. CONCLUSIONS AND POLICY RECOMMENDATIONS

The findings of the aggregated PCI survey data provide guidance for national policymakers - as supported by business leaders - to strengthen and accelerate reforms already underway, and undertake new initiatives to achieve more profound results in a shorter time-frame across all provinces. Recommendations below include initiatives with short-term and longer-term duration. Finally, we highlight ways that VNCI, the USAID-funded STAR Project and other development projects can support these initiatives undertaken by national and local governments.

#### Recommended Initiatives:

- **Implement regulatory reform:** Undertake a broad, decisive regulatory reform initiative within one year to simplify and streamline administrative procedures, formalities, and business requirements, eliminating those that: (a) are illegal or have no clear basis in law; (b) are no longer appropriate because the “old” enabling law/ordinance has been repealed or revised; (c) serve no legitimate public interest purpose ; (d) do not facilitate legitimate business; (e) are not consistent with WTO or other international treaty commitments; or (f) are not suitable for a market oriented economy. Simplification should increase transparency and eliminate administrative discretion in the application of procedures and requirements. This can be done quickly through a mechanism called the “Regulatory Guillotine” successfully carried out in numerous other countries.<sup>10</sup>
- **Introduce Regulatory Impact Assessment (RIA):** In an amended Law on Promulgation of Legal Documents, require RIA for all new laws and legal normative documents related to economic and business activities and develop the skills across line ministries and the institutional capabilities at the center of government to ensure economic cost/benefit and effectiveness analysis to guide improved policy-making. Later, amend the Law on Local Promulgation of Legal Documents to require RIA for all new legal normative documents affecting business and develop implementing capacity at the provincial and local level. In the short term, apply RIA methods and institutional practices on a pilot basis for selected laws and regulations affecting business while building capacity in relevant line ministries and the National Assembly.
- **Support revenue-backed bonds:** Support revenue-backed bonds to be issued by provinces to finance construction of toll roads and other revenue-generating infrastructure, while reviewing and revising the appropriate laws to enable such bonds to be traded in capital markets to support public debt financing by provincial and local governments. In the short term, conduct transaction-oriented pilot initiatives for revenue-backed bonds to be issued by provinces, which should be selected based on their political commitment, fund management capacity, ability to comply with

transparency and disclosure requirements, and ability to work with national government in addressing any changes required in relevant laws.

- **Strengthen key laws to support investment and enterprise growth:**

- Adopt an Administrative Procedures Law to improve the quality and fairness of basic administrative decision-making and new Law on Complaints that further improves the handling of complaints about administrative actions and decisions, possibly by providing for the creation of independent administrative tribunals to hear and settle some or all disputes with government agencies.
- Revise relevant laws and regulations to facilitate mergers and acquisitions.
- Amend the Bankruptcy Law to conform to international best practices.

These policy recommendations for national reform support an economic development framework for improved business environments across all provinces to encourage trade and investment that will result in equitable growth. The success of each province will still depend on its leadership and governing institutions to work collaboratively with central government, the non-state sector, and other civil society institutions to achieve social and economic objectives.

## END NOTES

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<sup>1</sup> The Vietnam Competitiveness Initiative (VNCI) is a USAID-funded economic growth project designed to improve the competitiveness of SMEs in Vietnam. VNCI approaches this mandate by focusing on supporting the implementation of reforms to the business regulatory environment at both the national and provincial levels. This paper was prepared by Dr. Edmund Malesky, the lead researcher for the PCI, Helle Weeke, and Do Le Thu Ngoc of VNCI, and Bryanna Millis of DAI. The paper also benefited from the input of Jim Winkler, Giang Doan and Janice Stallard of VNCI and John Bentley of STAR.

<sup>2</sup> To draw out implications of the PCI survey data for national policy, we developed national aggregates from responses to individual questions in the survey, and weighted them by the provincial portion of the population.

<sup>3</sup> The Regulatory Guillotine is a trademark held by Jacobs & Associates.

<sup>4</sup> In the context of regulatory reform initiatives, the terms “regulations,” “procedures,” and “requirements,” are most commonly understood as “Any procedure or formality that requires enterprises (and citizens) to interact with a government agency.”

<sup>5</sup> On average, registration at Provincial Department of Planning and Investments (DPIs) takes firms about 22.3 days from start to finish, while firms re-registering existing businesses under new business forms lose about 12 days on average. These time periods are longer than the respective official waiting periods set forth in both the 2000 Enterprise Law and the 2005, as so there is still room for improvement.

<sup>6</sup> Some caution is warranted: there is some evidence that some provincial officials are replacing the absolute number of inspections with single inspections of longer duration. For example, average duration of tax periods has increased about 30 minutes over the past year to 6 hours and 10 minutes. On the one hand, this development is positive, as it reflects the fact that many provinces are coordinating inspections among all regulatory officials and the combined inspections take longer. On the other hand, there is potential for abuse as the number of hours creep upwards. This trend should be watched carefully.

<sup>7</sup> Closely related is the extent to which firms are required to make informal payments to officials. While only 35% of firms report corruption as an obstacle to their business, a closer look at the data reveals some disturbing patterns. Over 74% of firms believe that it is common for firms in their line of business to make extra payments to local officials. 52% of firms believe officials use compliance with local business regulations to extract rents, and 65% of firms claim that negotiations with the tax authority are an essential part of doing business, even though the Value Added Tax (VAT) system leaves little room for negotiations. Revenue from the VAT, which could be more appropriately directed at infrastructure and social services, is being lost in the process.

<sup>8</sup> Although 60% of firms claim that the attitude of provincial officials toward firms depends on the firm’s revenue contributions to provincial budgets.

<sup>9</sup> PCI findings on this issue correspond closely to the Doing Business Indicators of the World Bank, where Vietnam ranks 170/175 on legal protections for investors and 94/175 for enforcing contracts.

<sup>10</sup> Countries include, among others, Korea, Croatia, Mexico, Ukraine, Moldova, Hungary, etc.