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Working Paper

## Aspects of private sector development in Vietnam

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**DUISBURGER ARBEITSPAPIERE OSTASIENWISSENSCHAFTEN  
DUISBURG WORKING PAPERS ON EAST ASIAN STUDIES**

No. 24/1999

**Aspects of Private Sector Development  
in Vietnam**

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## ***Foreword***

The private economy sector in Vietnam is a quite recent phenomenon that emerged in the process of the Vietnamese reform and renovation process (*doi moi*). In Western languages we find rather few publications addressing that sector. For many Western scholars Vietnamese material is rarely available. Therefore, more information might be of interest for scholars interested in Southeast Asian developments.

This Working Paper contains three contributions on private sector development in Vietnam. The first paper was written by Prof. Tuong Lai, former Director of the Institute of Sociology, National Center for Humanities and Social Sciences in Hanoi who is currently a member of the Research Institute under the Vietnamese Prime Minister.

Author of the second paper is Nguyen Duc Vinh, a research fellow of the Institute of Sociology in Hanoi. The papers from Tuong Lai and Nguyen Duc Vinh were presented to a workshop on "Private Entrepreneurship in China and Vietnam" at Gerhard-Mercator University Duisburg in May 1999.

The third paper, written by Thomas Heberer and Arno Kohl, addresses preliminary findings of a research project on the private economy in Vietnam, conducted in 1996 (a five months field study) and was funded by the German Research Council (DFG).<sup>1</sup>

The authors of the papers are solely responsible for the contents of their papers and the English version.

Duisburg, July 1999

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<sup>1</sup> For more information comp. Duisburg Working Papers on East Asian Studies No. 21/1999: *Entrepreneurs as Social Actors. Privatization and Social Change in China and Vietnam*, by Thomas Heberer.

# THE ROLE OF SMALL AND MEDIUM-SCALE BUSINESSES IN THE RENOVATION PROCESS OF VIETNAM

*Tuong Lai*

## ***1. Regional and Worldwide Outlook***

Together with overcoming the devastation of the typhoon Linda, which struck many southern localities, Vietnam is struggling against the economic and financial storm, which is sweeping over, not only Asia, but also the world as a whole. The latter is by far more worrisome.

Many Asian countries, the dragons or tigers which once were referred to as an economic miracle of the very dynamic Asia Pacific Rim, are now feeling what was warned by John Maynard Keynes as early as in the 30s of this century: **"Nothing good should be expected from a situation in which a country's development is the by-product of a casino."** Many Southeast-Asian countries are having a very difficult time because of the gamble that the estate and financial investors have taken. Keynes's prediction is also haunting many other economies outside Asia: **"The more perfect the investment markets the more prevalent the speculation. Speculators themselves are not dangerous if they were merely the water bubbles on a smooth flow of business transactions. The situation only gets serious when the business becomes a bubble on a whirl pool of speculation."**<sup>1</sup>

As a matter of fact, no matter of possible risks, large flows of capital that were pouring into the emerging markets in a relatively short time were, then, withdrawn all of a sudden without consideration of possible long-term consequences, causing the collapse of many economies which just a short while earlier were very proud of their miracle prosperity!

The bitter lesson of the monetary-financial crisis, which has become all too clear to many of the world's economists is the vulnerability of the economic and banking systems to unplanned or unregulated growth, which allowed banks to provide a tremendous amount of easy credits, thus accumulating huge amounts of bad debts. This crisis has caused national currencies to devalue by 30% to 60% and stock index to drop. But what is most significant is the fact that the stock and financial crisis in Asia has gone beyond the classic scenario of a market crisis. This is the crisis of the problematic economic structure itself which is profound and spreading gradually to the whole world, causing different consequences for different regions and countries depending on their levels of integration into the global economy.

Vietnam luckily is less (or will it only be later?) affected by the crisis than other countries in the region. According to David O. Dapice of the Harvard Institute for International Development, this can be explained in many ways: Vietnamese currency is not convertible, therefore a negative currency speculation is not likely to occur. Because of Vietnam's low income per capita the need for development outweighs the effect of the crisis. Since industrialization for import substitution is still in the very primary stage, it is not sensitive to the fluctuations of external demands as long as the foreign capital is still enough to make up for the low internal accumulation. Dapice, however, also warned that this does not mean the main impact of the current crisis in Asia (or the world) can be avoided by Vietnam. **It only comes later.** Unless there are bold reforms in the country's policies on finance, foreign exchange rate and investment, there is no hope to regain the 1990-1997 GDP

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<sup>1</sup> Howard M. Wachtel, "Three types of global taxes to curb accumulation", *Le Monde Diplomatique*, 10/1998.

growth rate of 8% to 9% per annum or even a lower rate of 6% to 7%. Vietnam risks to isolate itself from the global market.<sup>2</sup>

The Vietnamese leadership has also felt the impact of this crisis on the Vietnamese economy, **"particularly in export, import, foreign investment and the stability of Vietnam's currency. In this situation, the existing weaknesses of the economy, especially the low productivity and weak competitiveness of its goods can be seen more clearly."**<sup>3</sup>

In the context that the existing weaknesses and shortcomings are revealed more clearly when facing the acute challenge of the Asian and global crisis, we would like to discuss the role of small and medium-scale businesses in the present renovation process in Vietnam.

## ***2. Reconsidering the Starting Point***

The renovation in Vietnam was launched to save the country from the profound and prolonged socio-economic crisis, which lasted from the late 1970s to the late 1980s. There were many causes of this crisis, which led the country to the edge of the ravine. But the most obvious one were the failure of the model of centralized, subsidized, and planned economy, which accepted only two forms of ownership: collective and people's ownership, and isolating itself from the dynamic and constantly changing environment of the region and the globe.

The approval of market mechanism and multi-sectoral commodity economy which also means the acceptance of diversified forms of ownership, has truly generated a great motive for renovation, saving the country from the danger of collapse. Fifteen years have passed and **the start of this process** can be seen clearer than ever.

In an agricultural country where 80% of the population live in rural areas and 73% of its labor force is engaged in agricultural activities, giving back the right to control production to peasant households (even though they are still members of cooperatives, like the majority of the peasants in North and Central Vietnam or members of loosely regulated production groups) really generated a motive to boost agricultural production and economic growth. Beyond the expectation of many people, Vietnam developed from a rice importer, after the implementation of the new policy and mechanisms, which created a positive motive for production, to become the third, and then the second largest rice exporter in the world.

The drastic changes in rural areas had a strong impact on urban areas as well as on the industry. The open door policy brought the Vietnamese economy new tools to overcome stagnation and backwardness and to move forward gradually. A Vietnamese official asserted that **"Renovation means to get rid of the out-of-date and backward practices, renew what can be done and innovate new things." This is neither simple nor quick-to-get wisdom, especially when it comes to realize "the new things, which are in accordance with the rules and laws, able to save the situation, socially acceptable and in accordance with people's will."**<sup>4</sup>

To accept a multi-sectoral commodity economy with market mechanisms meant to correct the mistake of imposing one's subjective will on reality, regardless of historical laws and skipping stages with no consideration of the low starting point of all fields of a country which had just overcome a devastating war, and which needed to boost production quickly to improve the poor living standards of the majority of the population, especially the peasants. **To accept diversified forms of ownership in the market economy is the solution for the situation, which created a motive to trigger the development** of Vietnam during the past fifteen years. Starting from there,

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<sup>2</sup> David O. Dapice, "The global competitiveness of Vietnam. The warning flags", Harvard Institute for International Development, 12/1998.

<sup>3</sup> Le Kha Phieu, Nhan Dan Newspaper, New year issue, 1999: 1.

<sup>4</sup> Pham Van Dong, "Culture and reform", National Politics Publishing House, Hanoi 1994: 48,49.

the struggle for the development of new practices, and against backwardness, which hampered the development, is a prolonged, complicated and very challenging one. Defining the role of small and medium-scale businesses in the economy is not outside this difficult struggle.

### ***3. Businessmen and the Burden of the Past***

In the long history of Vietnamese society, traditionally a small-scale agricultural one, traders were not well treated. The mentality of attaching much importance to agriculture while oppressing trade was originated from within the small-scale agricultural society of wet rice cultivation. Traders were ranked the last in the society despite the existence of an old saying that "there is no prosperity without trade".

In the small-scale agricultural society, **genuine trade did not have enough opportunities to assert an important role**. For a long time in the Vietnamese history, agricultural productivity was so low that it hardly met the population's demand for food, let alone providing a surplus. Agriculture produced rice, and handicraft produced simple goods for consumption and production, but **small trading activities took place only on market days in small villages or in more distant districts**. With the domination of the opinion that "agriculture is pivotal", a small peasant household often engaged in agriculture, handicraft and trade at the same time. But **agriculture** was most important; **handicraft** produced consumer goods during the peasants' free time (between the planting and harvesting periods); trading activities were mainly for women, selling things at village markets to earn some additional income. Village markets were places where agricultural and handicraft products, made by peasants themselves were bought and sold. Until the end of the 19<sup>th</sup> century, almost all larger villages in the Red River Delta had a market of their own, which were held on certain days. There existed about 14 to 22 markets in a district, one market for every four to seven villages. There existed trading centers, which once were prosperous such as Ke Cho and Pho Hien. This marked a step in the development of commodity production in the Red River Delta, the cradle of the Vietnamese nation. However, until the late 19<sup>th</sup> and early 20<sup>th</sup> century, the Delta's economy could not get over the long lasting stagnation of a small-scale agricultural, pre-capitalist society.

In that small-scale agricultural economy, the Confucian influences exacerbated the mentality of attaching much importance to agriculture while oppressing trade and discriminating merchants. As "honor" was highlighted and "profit" was despised, vainglory was loved while attention was not paid to real business.

"Honor" outweighed "profit" and "profit" was strongly opposed in order to deter attempts to overcome misery as well as the wish to make oneself rich because that was considered to be a source of social instability. Manh Tu (a Chinese Confucianist) said: "The loss of a country is inevitable if everyone fights for profit, and if profit is the focus of people's relationships!" Actually, the goal of that philosophy was to maintain the small-scale agricultural production. Since agricultural cultivation was very hard and risky due to so many unexpected natural disasters, those who wished to earn big profit to get rich often quit agriculture and shifted to trade. Therefore, the essence of this philosophy was **to keep peasants in their villages to assure tax collection as well as soldier and labor recruitment for the ruling dynasty**.

Therefore, to oppose the will to get rich and chase profits, Confucianist guidelines were to be content with one's fate and social position, "not to blame God or anyone else for anything", and the best solution for poverty was to practice thrift. Confucianism advocated "**tri tuc**", meaning to know how to be satisfied with what one had and "**tiet duc**", meaning to know how to limit one's material desires. According to Confucius, "there are joy and happiness in a life where one merely eats vegetable, drinks water and uses his hands instead of a pillow." Praising only the joy and happiness of a poor life, and not that of a rich one did not mean Confucianism advocated "mortification" or "desire extermination". It only advised people **to resign themselves**. In order to do so, it was a must to understand the philosophy of "**an ban, lac dao**" meaning **to be satisfied with one's lot**. Methods

of governing the country and social management were well impregnated with this philosophy. **"It is worth to worry not when people get small shares but when they get unequal ones, not when people are poor but when they are unsettled. Because once equality is assured, poverty does not exist, once harmony is achieved, small shares do not matter, and once stability is guaranteed, there is no collapse."** Those arguments and philosophy all aimed at a single goal that was to maintain a harmonious and stable social order with the hierarchy based on the **principle of the king's ownership and the rule of the entire nation**: "Any land under the sky belongs to the King, and those who live on the land are all the King's subjects!"

The mentality of **"attaching much importance to agriculture"**, aimed at binding the peasants to the land in their small villages and communities to assure tax collection, soldier and labor recruitment for the feudal regimes, certainly led to **oppressing trade**. Because, as a matter of fact, **traders were most difficult to put under control, and at the same time most capable of undermining the principles and orders of a small-scale agricultural society**. To prevent this danger, Confucian ideology tried its utmost to demean the role of traders, by calling trade a mean job and traders mean men.

Of course, not all Confucian points of view and of its philosophy were accepted by Vietnamese society and culture. The cultural evolution is a process of domesticating external characteristics. Those external characteristics never maintained their original forms but adjusted to fit the host environment. But on the other hand, the long lasting Vietnamese small-scale agricultural society was a fertile land for those points of view and philosophy to take root. The practice of demeaning the rich and looking down upon the better off was rooted deeply in the spiritual life of Vietnamese small-scale agricultural society. **Wealth** alone was not enough, it had to go along with **nobility**. To be in the upper class of the society, one needed to have these two factors at the same time. Thus, there were enough reasons for traders to be despised. This mentality lasted almost endlessly. However, at times, one might think like King Tu Duc did in 1867: "In ruling my subjects, whatever I do, whichever order I make, I always carefully consider whether it might hurt my people, then why they are not prosperous, but on the contrary, the country's wealth gets rarer and rarer!" Ambassadors and envoys coming back from their missions abroad all agreed with the King's conclusion that: "Thanks to paying the utmost attention to trade, foreign countries got prosperous and powerful enough to dominate others. So it is the right thing to do, not only for them but also for us."<sup>5</sup> However, despite this thinking, the country's economic foundation and the toughness of its mentality and customs did not allow any reforms to take place. The Vietnamese economy kept stagnating in the system of self-sufficiency in a small-scale agricultural society and was in no way shifted to commodity production. Traders and businessmen could never rise in the social hierarchy as they were destined to be at the bottom!

Even after Vietnam's resounding victories in its wars against foreign occupation in 1954 and later in 1975, the role of businessmen continued to be undervalued. They were mentioned reluctantly when some of them made generous contributions of their assets to the state treasury during "golden weeks" after the August Revolution or sheltered and supported revolutionaries just to get very modest acknowledgment, not to mention poor treatment. This was easy to understand because traders or businessmen were always associated with the "bourgeoisie class", the class against whom the Revolution was aimed. The process of "joint venture between private and public sectors", which was launched to reeducate the bourgeoisie in the North and that was repeated in the South after 1975, aimed at reorganizing private trading and industry sectors, in theory and in practice, put traders and businessmen on the other side of the front line during peace.

The economic model with a centralized, planning and subsidy mechanism, which denied market elements certainly did not have any place for businessmen, who were described by some ideologists

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<sup>5</sup> Tran Van Giau: "The development of Vietnamese ideology from the 19th century to the August Revolution", The Sociology Publishing House, Hanoi 1973: 366.

and officials at that time as the incarnation of the bourgeoisie class. The prolonged and serious socio-economic crisis, signaling the collapse of that model, which was "**strange to socialism**" as Pham Van Dong put it <sup>6</sup>, led to the formation of reform policies, which accept a multi-sectoral commodity economy, operating in the market mechanism with socialist orientation.

The reform in the way of thinking about the economy led to the formation of a new way of thinking about businessmen, who played an indispensable, not to say vital role in the market economy. In practice, the society pays less attention to which sector they belong, and thus no longer associates them with the "bourgeoisie class". "The reform tendency prompted the drastic changes, especially in the way of thinking, which is very difficult, more than any other reform."<sup>7</sup> Life has proved it right.

The burden of the past, carried by businessmen - who were insultingly called "mean traders" - is not easily undone overnight, although many state employees wish to be directors of enterprises, a kind of businessperson in the state-owned sector which enjoys real respect. In a market economy, which is still at the very first stage of its development after a long history of discrimination and deny, not yet assured a firm stand in the insufficient legal framework, where the wildness of a captured free market that still exists to some extent is the favorable condition for evil practices of a handful of condemned businessmen, the historically legitimate prejudice is very hard to dispel completely.

However, life itself will automatically adjust to the practical conducts. The economic evolution with its own requirements will create the kinds of public opinions which satisfy the development demand. The public will honor those businessmen, who fulfill the tasks that the society assigned to them in order to be the main force in promoting production, creating new jobs for workers, raising the competitiveness of Vietnamese goods in the market in order to further step up Vietnam's integration into the regional and global economy, aiming at finding out and making full use of its advantages and effectively coping with challenges.

#### ***4. The Role of Small and Medium-Scale Businesses in Solving the Most Burning Social Problem: Unemployment***

With the principles of a multi-sectoral commodity economy operating with market mechanisms, all assets of the people can be converted into capital in order to make investments and earn profits for their owners. Whether the capital's owners are willing to make investments to earn profit depends on many factors: their habits of using money, whether they are confident of the state policies and laws, and whether the investment environment is favorable.

From the perspective of the country's interests, the more people invest in ventures to earn profit, the better the conditions there are to develop the economy and promote social progress. The lesson drawn from the economic crisis in Asia urges the formation of policies facilitating the investment of small and medium-scale businesses to expand their production and activities. The Taiwanese economy is a good example. The reason why Taiwan is less shaken by the storm of the crisis is mainly due to the fact that in this country, the small and medium-scale businesses play an important role in the economy. This type of business, which goes along with private ownership in the cooperative division of labor, is praised for being dynamic, flexible, and highly effective. It offers many job opportunities for local workers, requires small investment and a quick return of the capital, could easily be shifted to other products that the market demands, promptly upgrades technology and improves the quality of goods.

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<sup>6</sup> "Ho Chi Minh and Vietnamese people on the path to a strong country and a prosperous nation", National Politics Publishing House, Hanoi 1993: 34.

<sup>7</sup> Pham Van Dong: "Ho Chi Minh and Vietnamese people on the path to a strong country and prosperous nation", Hanoi 1993: 34.



Under present conditions and given the above mentioned advantages of the small and medium-scale businesses and a Vietnamese economy facing acute challenges from the economic-financial crisis in Asia and the world and the need to continue stepping up the renovation process to develop the country, it is the right thing to take advantage of these businesses.

On June 20, 1998, the Vietnamese Prime Minister issued a decree on temporary regulations for the small and medium-scale business, which defined them as any businesses with a registered capital of less than five billion Vietnamese dong and an average annual number of workers of less than 200. According to this definition, 80% of businesses in Vietnam are small and medium-scale (including public and non-public sectors), employing about 25% of the labor force and contributing approximately 24% to the country's GDP. However the development of small and medium-scale businesses is not very positive. The mobilization of domestic capital for economic development is considerably low in comparison with the demand as well as the potential of the people. The apprehensiveness of people remains strong, which prevents them from being willing to invest in business. Even more noteworthy is the unwillingness to invest in private enterprises and companies. There are cases, when a number of household businesses (as defined in the Decree 66 of March 2, 1992) have reached a fairly large scale of business but do not want to form companies or operate as private enterprises. Some private enterprise, who are in a good shape, even want to dissolve themselves to register their operations as household businesses as defined in the 66 decree! In other words, many investors are not willing to do business officially on a large scale, or in fact, find it difficult to do business smoothly as a company or private enterprise.<sup>8</sup>

Yet, the main guideline for the next step of development to overcome difficulties is: **"Fully tap the internal resources, at the same time expand international cooperation, firmly maintain political stability, step up industrialization and modernization", of which "agricultural and rural development is the basis and driving force for industrialization and modernization".**<sup>9</sup> More than ever, the people's potential resources should be mobilized and small and medium-scale businesses are the most suitable form to do this.

A recent World Bank report to the Conference of Vietnam's Donors, held on December 7-8, 1998, titled "Vietnam Overcomes Challenges" gave some noteworthy advice:

"Only by fully using the energy and dynamic of the entire nation can Vietnam manage to overcome challenges, increase economic efficiency and attract more capital from both domestic and external sources. So far, farmers, state-owned enterprises and foreign private companies are the main driving forces for the country's growth. Still, the small and medium-scale businesses are playing a very modest role, especially in the field of industry. Nevertheless, they are the ones, which use resources most effectively and the main factor that creates new jobs in other countries in the region. They, therefore, should be encouraged in Vietnam."

The following advice was given in the second chapter of the report called "To free the potential of all Vietnamese people", after reviewing the economic situation and giving a conclusion in the first chapter:

"The shock of the regional crisis has affected Vietnam through a sharp decrease in foreign investment and export growth - equal to approximately three billion US-\$ or 12% of its GDP. This is posing a threat both to external relations and fiscal balances. With this year's slow agricultural growth, the total GDP growth is expected to be only half of last year's figure (based on the figure of the first nine months of 1998), although the government expects only a one-third decrease. The sharp decrease of GDP growth has posed a threat to the impressive course of hunger eradication and poverty elimination that Vietnam has launched."

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<sup>8</sup> Vu Quoc Tuan: "To create a socio-economic environment for the formation and development of business", The Sociology Journal, No. 4/1998: 3.

<sup>9</sup> Le Kha Phieu: Nhan Dan Newspaper, New Year Issue, 1999: 1.

From a sociological perspective, we would like to mention only one main reason why small and medium-scale businesses should be developed, that is its ability to attract labor force, and create jobs, the most burning social issue in Vietnam at present.

In terms of the population structure, people below the age of 16 count for 45%. The unemployment rate is about 6%, and 10% in urban areas alone. The employed in rural areas, including those with part-time jobs is equal to about 10 million people. Meanwhile, the supplementary work, and even the revival of traditional handicrafts have not been able to provide enough jobs to meet the employment demand.

It is worth noting that while the number of laborers in the public and cooperative sectors has decreased due to restructuring and streamlining public enterprises, the number of non-public enterprises has increased. The 1990 figure was 1.5 million, 1993 2.1 million and in mid 1995 2.4 million. Besides, about one million others are working for small-scale household businesses with unstable jobs. Although this number is significant, it is a very small number as compared to the number of unemployed people.

The ability of the industrial zones and export-processing zones to create job opportunities is also appreciated. Until December 1997, there existed in total 45 industrial zones and three export processing zones, which employed about 65,000 local laborers (among them, in Ho Chi Minh-City and Dong Nai province alone more than 20,000 people were employed).

However, a closer analysis reveals: If we look at the state-owned enterprises (the public sector) and Joint Ventures with foreign companies (foreign invested sector), we will get a better vision of the labor and employment issue:

- After streamlining the state-owned enterprises during 1990-1992, the number of jobs in this sector decreased by 400,000, and the remaining number of jobs is about 1.78 million. In 1995, this number decreased by another 600,000, reducing the number of remaining jobs to 1.72 million.
- Meanwhile, the Joint Venture sector, with its advantages in terms of capital and land use conditions created only 90,000 jobs over five years.

This means that the two forms of business management, which are developing rapidly due to their advantages of tax preference treatment, land lease and access to capital resources **were not able to create a considerable amount of jobs during the period 1991-1995.**

This difficult situation in job-creation indicates the weaknesses of the incentive system for investors in the context that the most important relative advantage of Vietnam recognized by almost all analysts is a conceivably cheap, disciplined, and educated labour force.

However, after five years with the amount of six billions US-\$ investment, 90,000 jobs were created in all sectors; the average cost was 66,700 US-\$ per created job. In addition, taking into account the expected direct foreign investment, during the period 1996-2000 there were about 60,000 new jobs created annually. Anyway, the number of new jobs created each year was only about 5% of the annual increase of the total labour force! This was the calculation before the regional crisis!<sup>10</sup>

Taking into account the decrease of jobs in the state-owned sector and the increase of jobs in Joint Ventures (mostly between state sector and foreign investors), the total number of jobs for the state sector and Joint Ventures during the five years declined. Which sector, then, has created new jobs?

According to the up-to-date statistical data for Ho Chi Minh-City, although the state sector occupied 70% of the total capital of the economy, it was the non-state sector that draw 77% of the labour force of the largest city in the country.

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<sup>10</sup> The report "Phat trien nang luc de xoa ngheo o Viet nam: Tien kip" [Capacity development for poverty elimination in Vietnam: Catch up], ed. by UNDP & UNICEF-1996: 29.

The data in the table below indicate the proportion of contribution to GDP from those sectors in Ho Chi Minh-City during the five years 1993-1997:

Table 1: Proportion of contribution to GDP from economic sectors in Ho Chi Minh-City (%)

<i>Indicators/year</i>	<b>1993</b>	<b>1994</b>	<b>1995</b>	<b>1996</b>	<b>1997</b>
<i>1. Total GDP</i>	100.0	100.0	100.0	100.0	100.0
State economic sector	52.2	51.3	49.2	47.9	46.9
Non-state economic sector	40.4	40.5	39.7	38.8	37.4
Foreign investment sector	7.4	8.2	11.1	13.3	15.7
<i>2. Total budget</i>	100.0	100.0	100.0	100.0	100.0
Domestic budget, therefrom:	64.3	64.1	60.0	61.6	64.9
State economic sector	42.9	37.6	29.5	27.0	25.6
Non-state economic sector	8.2	8.4	8.9	10.78	11.1
Foreign investment sector	1.8	4.8	7.5	9.5	9.2
<i>3. Total employment</i>	100.0	100.0	100.0	100.0	100.0
State economic sector	21.7	21.9	24.1	22.8	23.1
Non-state and foreign investment sector	78.3	78.1	75.9	77.2	76.9

This data reveals that the non-state sector created most of the new jobs, and it does so very rapidly and with low costs.

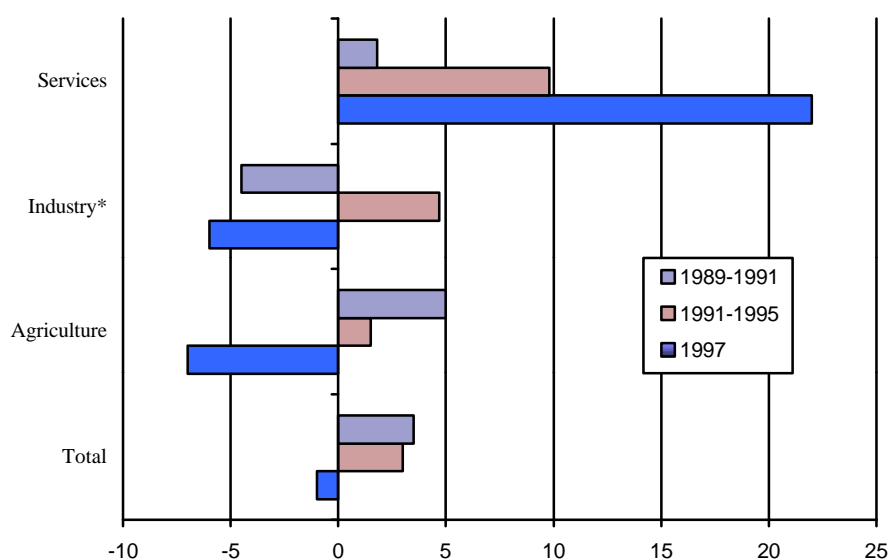
According to the economic report from the World Bank mentioned above, for an average state enterprise creating one job costs about US-\$ 18,000 whereas it costs only US-\$ 800 to do so for a small or medium-scale enterprise.

It is necessary to match this figures with the real situation of slowing-down of job creation starting from 1996 (before 1996 the increase of new jobs was in pair with the increase of the labour force). In 1997, for the first time since the implementation of DOI MOI, the employment rate fell under 0.6%. In agriculture and industry, labour and employment decreased 6.2% and 5.6% respectively.

The reduction in the industrial sector was due to the fact that industrial production demands more capital. While in other sectors, although productivity in the service sector was still low, over half of the surplus labour entered into the rural service sector and the rest into the urban service sector. The decline in the service sector caused many difficulties for this sector in attracting labour, which resulted in a higher unemployment rate.

Slow increase of the service sector reflected inactiveness of the banking system by its own difficulties and reduction of growth in the commerce and estate trading. Slow increase in tourism and hotel services happened due to less attraction of tourists as compared to other countries in the Asian region.

Figure 1: Increase of employment according to economic branches (%)



Note: \* Reduction in the period 1989-1991 by closing about 2000 state-owned enterprises.

Source: General Statistical Office.

All these factors impacted immediately to employment, which is a sensitive and vulnerable sphere. A more noteworthy fact is labour and employment in rural areas where 90% of the poor are concentrated.

As mentioned above, the course of DOI MOI was initiated in rural areas, and at present, for coping with the new challenge from economic and fiscal crisis in Asia and the world and the demand of speeding up the cause of DOI MOI, rural areas and agriculture were defined as basic and motivation force for industrialization and modernization, the situation in the rural areas will strongly influence the urban areas, industry and the entire social-economic situation of the country.

Reducing poverty in Vietnam during the last few years was an impressive achievement. The above mentioned World Bank report recognized that the percentage of poor people dropped from over 70% in the mid-80s to 50% in 1993. Till now there are only 30-35% (this number will be more accurate after the adjustment in 1999) counted as poor. There are few countries in the world having such a rapid and pervasive economic growth.

Nevertheless, this report also warns that: "This progress has been threatening" because "if without strong measures solving the present decline of economic growth, the poverty will increase considerably in the coming two years". Poverty increases closely with the surplus labour in rural areas. The number of labourers without employment will flow into urban areas while there are about six million labourers who are unemployed.

Unemployment and underemployment, especially among young people in the working age is a main reason for the increasement of social maladies like drug abuse, prostitution, robbery and Aids.

How to solve the problem of surplus labour in rural areas? At present, the Vietnamese government has many solution policies in terms of rural and agricultural development. It is easy to realize that the strategy for rural development will depend mainly on the capacity of creating employment in non-agriculture branches. Transformation of the production structure, diversification of occupations, moving a major part of agricultural labour from paddy and non-paddy agriculture or husbandry into food processing, services etc. The experiences from countries which successfully increased the income level in rural areas without increasing rural-urban migration indicate that this

success was due to strong development of rural industry. Vietnam tries to carry out rural-agricultural industrialization and modernization under difficult conditions: lack of capital, of technology, and lack of qualified cadres. At present, almost 24,000 enterprises in rural areas are operating on household level. About 15% of these households receive loans from banks, however, more than 70% of all households are in demand of capital.

Since the land law was issued in 1993, plantations increased rather strongly. Within five years up to 1998, the number of plantations was estimated as follows:

*Table 2: Number of Plantations*

<b>Province</b>	<b>Number of plantations</b>
Lao Cai	3,640
Nghe An	3,200
Dak Lak	4,000
Binh Duong	1,539
Binh Phuoc	2,700
Lam Dong	4,963
Yen Bai	9,226
Phu Tho	200

In Yen Bai province alone, the number of plantations involved 11% of all peasant households in that province and they contributed over 60% of the export value of the province with 60 ha concentrating on forests. The average area per farm was 6.13 ha in which the forest area occupied 70% and cultivated land 13.7% of the total land. 29% of the plantations had an average land below 6 ha; 24% of the plantations had an average land of over 10 ha. The products from these plantations were sold very quickly, the trade share went up from 60% to 80%. Especially plantations that produced rubber, coffee and tea had a trade proportion up to 95%.

Exclusively in Yen Binh district, Yen Bai province, the analysis showed that the capital of these plantations occupied 70%. Loans from banks and private persons made up 26% and that from other sources 4%. On average, each farm had a capital of 14.3 million VND. For the plantations near district centers, the average capital was higher, between 20 million and 47 million VND.

It should be taken into account that the land source of these plantations from the state farms was 98%; the plantations with land transfer counted for 1.8% and the plantations with land changed from waste land into arable land by their own was 0.1%.

It should be emphasized that this kind of plantations - a special type of agricultural enterprises - were formed and developed primarily in hilly and mountain areas where more land is available. In contrast, in the delta areas where land is scarce, density high, and surplus labour redundant, this kind of plantations were not established.

The matter is that in areas with scarce land that are densely populated the development of small and medium-scale enterprises in the non-agricultural sector contributes to solve the most urgent social problem at present, i.e. employment for about 10 million labourers. Solving this issue will have a positive impact on other social-economic issues. As mentioned above, creating one job in small and medium-sized enterprises would require about 11 million VND (equivalent to 800 US-\$) while in the state enterprises it would require about 240 million VND (equivalent to 18,000 US-\$). The key factor is to adopt appropriate mechanisms and policies that may convince those who have capital and are willing to invest in processing and service enterprises in rural areas. If such mechanisms and policies are not adopted, the government would not have the capacity to solve the issue of surplus labour in rural areas, which is an obstacle for economic development and social stability in rural as well as in urban areas.

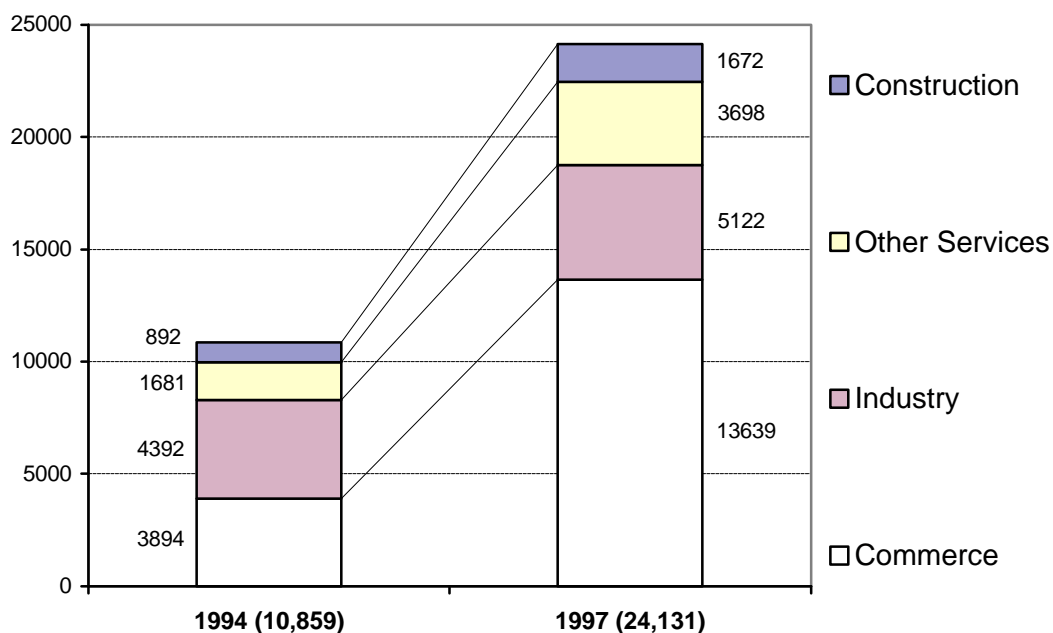
Together with promoting the development of small and medium-scale enterprises in industry and services, the development of the rural and agricultural sector should promote the industrial and service branches in order to enhance employment. This is particularly true for labour-intensive branches, e.g. garment, footwear, food processing and tourism.

In recent years, although the level of industrial growth in general had gone beyond the level of growth of services, the number of small and medium-sized private service enterprises was higher than that of industrial ones. This indicates the tendency of industrial growth based on large enterprises with large capital. The number of commercial companies increased three times while the number of construction and service companies increased two times. The small and medium-sized service enterprises increased because they were not restricted by state enterprises (comp. figure 2 on small and medium-scale private enterprises).

90% out of 5,000 industrial enterprises belong to four branches: food and beverage (56%), garments and footwear (9%), metal and metal products (17%), wood and paper industry (11%). In general, these industrial branches cost highly, but they are a potential for expanding small and medium enterprises. However, till now the number of small and medium-sized enterprises occupied only 2% of industrial output and showed a slow growth. The reason for this slow increase was mentioned above. Nevertheless, due to limitations of production aiming to substitute import products, the export will become the driving force for production. In light industries, export requires competitive prices and strict administration. Except the case of exports based on quota or their own potential (e.g. exports of processed goods to Western Europe), all countries including China realized that small and medium-sized private enterprises could meet this demand.

While the development of small and medium enterprises was very slow, especially the enterprises using highly qualified labour and that possess a large export potential. In that firms labour demand is on the rise. Every year, the number of labourers increased about 1.33 million on average, from 1996 to 2010 there will be a demand of about 20 million new jobs.

Figure 2: Small and medium-size private enterprises in 1994 and 1997



Source: General Statistical Office.

The small and medium-scale enterprises will play a very important role in solving the demand of 20 million labourers in the coming fifteen years. Therefore, the idea to **rely on one's own strength** in order to overcome the difficulties mentioned should be translated into specific supporting

mechanisms and policies. Public opinion should be developed in order to put small and medium-scale enterprises in a right position, creating good conditions for the development of those enterprises in order to use their potential thus contributing to the enrichment of the people, making the country strong, and the society civilized and equal.

In the past, it was Degree number 10 on agricultural management reform that created production and trade autonomy for peasants and thus initiated an impressive process of making the agricultural production and rural development prosperous, leaving strong positive imprints on urban and industrial development in the reform process. Today it would require a strong policy aiming at liberating small and medium-scale enterprises from unnecessary limitations in order to stimulate a new impetus. First of all, we have to make full use of processing industries, which are more labor-intensive and provide more products for export, especially food processing industries. This is not only in the interest of rural and agricultural development, but also contributes to speeding up poverty eradication programs that have been an outstanding achievement of DOI MOI, and moreover helps to solve unemployment problems in urban areas, pushing up industrial growth and exports.

Such impetus is worthy to expect, and hopefully it will be a policy solution that is in accord with the natural law, effective, capable of recovering the situation, socially acceptable, and in accordance with the people's wishes.

# OVERVIEW OF NON-STATE SMALL AND MEDIUM-SIZED ENTERPRISES IN VIETNAM

*Nguyen Duc Vinh*

Over the past decade, since Vietnam launched its "Renovation Policy" (doi moi) and developed a multi-sectoral economy, many small and medium-sized private enterprises (abbreviated as SMEs) have been established and grown considerably, increasing their role in the national economy.

## ***1. What do we know about non-state small and medium enterprises in Vietnam?***

Results from studies, surveys, official statistics, publications, and other articles published in recent years on SMEs, can be summarized as follows:

### ***1.1. The development of SMEs plays an important role in the country's development***

Most researchers and policy-makers agree on the important role of SMEs in the industrialization and modernization process in Vietnam. The importance of that role can be expressed in the following ways:

- promoting economic growth: SMEs account for a major part of total national production and trade, hence contributing significantly to gross domestic product, state budget and exports;
- encouraging economic structural adjustment as part of the process of industrialization and modernization. SMEs attract labor from agriculture to work in the service and industrial sectors, and from the state sector to the non-state sector. At the same time, the development of SMEs also helps to adjust and diversify the structure of the industrial sector and reduce the need for imports;
- speeding up the urbanization process; SMEs stimulate economic development in the countryside, narrowing the development gap between rural and urban areas;
- having the ability to meet fast-changing and diversified market demand appropriately, thus making the country's economic development more dynamic;
- creating many new jobs, both for skilled and unskilled workers, help to solve today's major political issue, unemployment, and improving employees' income. The average income of an SME employee is estimated to be three times that of an agricultural laborer;
- mobilizing effectively public funds, which seems to be huge but used to be saved at home;
- supporting and promoting the development of large enterprises through their links with these enterprises. At the same time, SMEs themselves often develop into large entities;
- training business managers for the market economy. SMEs are rapidly adopting new technologies, and form breeding grounds for the development of scientific and technical progress.

So how have non-state SMEs developed, in both quantity and quality?

### ***1.2. Although some initial achievements have been recorded, until now, the development of SMEs in Vietnam is still far from the optimum level***

According to the government's temporary regulations issued in June 1998, the criteria for being a SME are to have a capital value of less than VND 5 billion, and an average number of employees



across one year of less than 200. Prior to this regulation almost all documents categorized SMEs using the following criteria, based on the Vietnam Chamber of Commerce's requirements:

Table 1: Categorization of Small and Medium-sized Enterprises

Size of enterprise	Industrial sector		Trade and service sectors	
	Capital (VND million)	Labor (employees)	Capital (VND million)	Labor (employees)
Medium enterprise	5-10	200-500	1-5	50-100
Small enterprise	<5	<200	<1	<50

Source: According to the Vietnamese Chamber of Commerce.

Based on these criteria, most non-state enterprises (including joint-stock companies, limited liability companies, private companies and sole-proprietorship companies) are of small and medium size. Until 1996, the proportion of private and limited liability companies with capital of more than VND 5 billions was very small (comp. table 2).

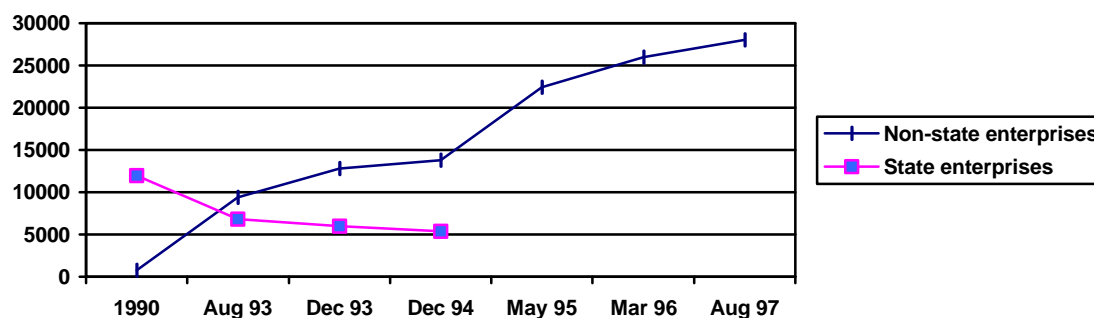
Table 2: Capital of non-state enterprises (%)

Capital (billion VND)	Private enterprises	Limited liability companies	Joint-stock companies
<1	95.1%	69.0%	14.5%
1-5	4.4%	25.7%	27.9%
>5	0.5%	5.3%	57.6%
<b>Average</b>	<b>168.8 million VND</b>	<b>775.1 million VND</b>	<b>10,330 million VND</b>

Source: Statistical Yearbook of Vietnam, Hanoi 1995.

During the period from 1990 to 1997, private companies as well as non-state enterprises in general, grew rapidly in total number, the number of employees, and the level of invested capital and revenue. According to statistical data, in 1986 (when the reform policy was first applied) the number of private enterprises was insignificant, rising, by 1990, to 770 with approximately 100,000 employees. In August 1993, there were 9,389 non-state enterprises with nearly 500,000 employees.

Figure 1: Number of enterprises



By December 1993 the number had increased to 12,738 with a total capital value of VND 3,979 billions. At the end of December 1994, there were 13,772 private companies, 5,120 limited liability

companies and 133 joint-stock companies, totaling 19,025 enterprises with a total capital value of VND 6,621 billion (equal to 13.6% of the value of State-owned enterprises). In June 1995, the total number of each of the three forms of enterprises was 22,432 with a capital value of VND 8,256 billion and VND 35,547 billion revenues. In March 1996, the number of non-state enterprises reached nearly 26,000 (comp. figure 1) with a capital value of VND 10,584 billions. Thus, during the period 1990 - 1997, the development of the SME sector was remarkable, and has contributed to the high growth rate of the Gross Domestic Product (GDP) over the past few years.

SMEs are involved in almost every sector of the economy: industry, agriculture, aqua-culture, mining, processing, construction, trading and the service sector. However, most of the capital was invested in the trade and service industries, followed by processing industry and aqua-culture. These industries have a substantial domestic market, with a potential for significant profits, and a high rate of return. According to statistics from 1995, the trade and service sectors accounted for 63.3% of total enterprises and 50.3% of capital value.

SMEs are located unevenly through the country, centering on urban areas, especially large cities. 68% of joint-stock companies, 59% of limited liability companies and 12% of private companies are located in Hanoi, Haiphong and Ho Chi Minh City alone.

Between 1995 and 1997 however, the private sector contribution to GDP increased only modestly. For example, its contribution grew by 3.1%, 3.3% and 3.4% in 1995, 1996 and 1997 respectively. SMEs as well as private enterprises' effectiveness is still very low, even in comparison with SOEs (comp. table 3). This limits the potential for accumulation of capital for further development.

*Table 3: Effectiveness of the enterprises in 1995*

	Rate of profit/capital	Rate of profit/turnover
<b>State enterprises</b>	0.054	0.038
<b>Collective enterprises</b>	0.048	0.022
<b>Private enterprises</b>	0.057	0.018
<b>Joint-stock companies</b>	0.018	0.010

*Source: Data from an economic survey in 1995, General Statistical Office.*

Since the onset of the regional economic and financial crisis, the growth rate of SMEs has slowed down both in number and in effectiveness.<sup>1</sup> Many enterprises were unable to continue operating and went bankrupt. Some enterprises, which had been successful, are now making losses. According to a survey in Hanoi and Ho Chi Minh City, less than 50% of enterprises currently operate effectively.

In brief, although some initial achievements have been recorded, the development of SMEs in Vietnam is still far from the optimal level.

### ***1.3. Some advantages of SMEs***

In the present socioeconomic situation of Vietnam, SMEs have the following advantages:

- Legally, the operation of SMEs as well as of private enterprises in general are accepted, protected and encouraged by the government. The role of SMEs in the country's development is also recognized and respected.
- The management and production units are small, flexible and easy to adjust. Direct management and supervision, without intermediate stages, contribute to lower administrative costs.

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<sup>1</sup> Nguyen Cuc, "Building conditions of assistant frame for small and medium enterprises in Vietnam", in: Economic Studies Review, No 238.

- SMEs are often more active and responsive to changes in the market, even in times of crisis. They can also more rapidly change their activities and products to meet market demand. In addition, they can more easily change the number of employees.
- The initial start-up investment of SMEs is relatively small. Therefore, the costs can be covered rapidly.
- SMEs can make use of Vietnam's abundant and cheap labour force, low training costs and the low cost of insurance for labourers.
- Apart from these above advantages, SMEs are also supported by domestic and foreign institutions through capital investment, professional training, technology and market development.

#### ***1.4. Disadvantages and Limitations of SMEs***

Besides the above-mentioned advantages, SMEs in Vietnam also have shortcomings including:

- SMEs equity is often very limited (comp. table 2). They lack capital for maintaining and expanding their business and production. Meanwhile, the possibility to expand capital resources is very thin. According to the findings of a research in Hai Duong and Hung Yen in 1995, most of the enterprises' sources of capital stem from equity, followed by private borrowing, stock capital, and lastly, borrowing from state banks. State credit only plays a modest role in promoting the establishment and development of non-state SMEs.
- The material and technical base of SMEs is often very weak, characterized by backward technology. An important reason for this is shortage of capital. Many enterprises also lack the necessary information and consulting services on technology transfer, especially in rural areas. The ability of small enterprises to handle and use modern technology is limited. Many proprietors tend to focus their business strategy on industries requiring small investments and short break-even periods, often hesitating to renew technology. Moreover, the SMEs also face difficulties in terms of administrative procedures and taxes for imported technology.
- Places for productive activities are usually very small and far below the actual need of SMEs, especially in urban areas and large cities.
- The market for SMEs products is small, unstable and very competitive. Only a few items can be exported. Some researchers offer the following explanation: low quality goods and high prices due to backward technology; poor promotion and advertisement of the goods being offered; competition from illegal and tax-evading imports due to limited government control and protection.
- In general business management skills are not up to the mark. Only a few owners are equipped with business knowledge of a market economy. Most of the proprietors run businesses based on their own experience. In addition, their understanding of business law, and attitudes towards the rule of law is questionable.
- Although labor is abundant, most job-seekers are unskilled workers. While only a small number of SMEs can provide training for their employees, government support in training is negligible.
- Infrastructure is insufficient, in particular transportation, electricity and clean water. There are also significant differences between different regions, and between rural and urban areas.
- Many owners of SMEs do not fully believe in the current policy to develop a multi-sectoral economy. Laborers and the public in general still don't trust private enterprises, an attitude that finds its root in Vietnamese economic history.

- Some business associations and communities have been set up but are ineffective. Small enterprises doing business independently without linking with large enterprises will find it hard to overcome strong competition in the marketplace.

### ***1.5. Government's policy and management over SMEs***

- The freedom to do business and to set-up business is stipulated in the 1992 Constitution. Many related laws have been promulgated, and some have been revised several times. In principle, all government policies are aimed at stimulating the development of SMEs.
- However, the government has not established a concrete strategy and promulgated a specific law for SMEs. In general, law for SMEs are still in the process of completion, and some issued documents are not appropriate to the new situation.
- Although efforts to improve the situation have been made, the administrative procedures necessary to set up companies and register business activities are still too complicated, lengthy, and inconsistent, causing many difficulties for enterprises. Corruption in the government's administrative system has not been appropriately dealt with, and illegal trading, tax evasion and manufacture of counterfeit products have not been fought effectively.
- Inequality between small and large enterprises, and between private and state enterprises still exists, especially in the credit and investment policies of the banking system, and the land-use policy.

### ***1.6 International organizations' supports***

Small and medium enterprises have attracted more interest and support from international organizations than any other part of the Vietnamese economy. Many projects to support SMEs are sponsored by international organizations such as: ZDH (The SMEs-supporting Association of Germany), UNICO (The United Nations Technology Development Organization), ESCAP (Economic and Social Commission of Asia-Pacific), SMEs Development Fund of Vietnam, the EU, and the ILO (International Labor Organization).

These support projects are quite diversified, including activities such as the establishment of the fund for SME development, granting loans, providing training for business starters, business development constancy, and export promotion support.

## ***2. Issues that need to be studied***

In recent years, the term "small and medium enterprises" have appeared more and more in publications, books, journals as well as in the mass media of our country. This demonstrates the interest of the society in the development of Vietnamese small and medium enterprises. However, it also seems that we do not fully and comprehensively understand the issues involved, especially the social aspect related to SMEs. Here we put forward some aspects:

First, the concept "small and medium enterprises" itself has not been clearly defined. Statistical data, research findings, and political documents use different definitions, thus making direct comparisons difficult. Moreover, even if the concept is agreed, it is not easy to identify the actual levels of capital and profits amongst these enterprises. In Vietnam, there are many reasons for enterprises to declare a higher level of capital than the real figure, or the other way around. Some people estimate that the actual figures are "3-4 times the registered level of capital".<sup>2</sup> If that situation continues, it might be very difficult to set out the best policies for small and medium enterprises. The question is not only why enterprises present false data but also how can they be allowed to do so?

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<sup>2</sup> Hoang Kim Giao, "Capital of small and medium enterprises", in: Economic Studies Review, No 219.

In a society in transition from a centralized subsidy-based economic mechanism, to a market economy, such as in Vietnam, there are two sides of every field of the economy: official and unofficial activities. Official business data frequently differs from the actual situation. E.g., the "administrative transaction" expenses may be for one item, but are declared for another one; in reality the conditions for borrowing money and for winning a tender are not always as simple as stipulated. These and many other phenomena are easily found out just by reading Vietnamese newspapers. All of them are close to "unwritten laws" that all enterprises must obey and sometimes obey even more strictly than other official laws if they want to continue to exist and develop.

Operating in such an environment, together with the difficulties and shortcomings summarized above, the risks for small and medium enterprises are relatively high. To compete and develop, enterprises have to take into account the "unofficial" dimension. The quicker small enterprises want to develop into large enterprises the more they have to take account of the "inofficial" side and sometimes to a dangerous extent - the extent to which the line between success and law violation is very thin. Perhaps it is not a coincidence when most of the recent important economic law violation cases are related to enterprises, which used to be regarded as successful.

On the other hand, when enterprises cannot or do not dare doing so, limiting the "official" degree in their business activities is often a simple measure to protect their interests. Some private companies want to dissolve their business in order to register their operations under Decree 66 (household business). In other words, many investors do not want to do business on a large scale, or in reality, they cannot do "business in the form of companies or private enterprises".<sup>3</sup> Short-term interest is often put before long-term strategy, and sometimes even before an enterprises' prestige. This is very worrisome for the development prospects of small and medium enterprises in our country at the moment. Are the conditions for that development not only the amendment of some laws or degrees, but further reform of the legal framework as well as management mechanisms?

The social acceptance of SMEs would have great significance for the development of this sector in the future. For a long period prior to the reforms, private sector activities were limited and discouraged in many ways. As a result people are often biased against, disrespect, and despise this group of enterprises.

Nowadays, perhaps, many people cannot fulfil their dream of being "proprietors". However, some of them still keep in their mind the image of businessmen as the rich, opportunists, and exploiters of labor, rather than those who produce goods and create jobs for society. Employees of small and medium enterprises do not believe in and have not been content with their work, unlike those who work for state-owned or large enterprises. Therefore, it is hard for small and medium enterprises to attract qualified and highly skilled labor compared to the state sector unless they pay much higher salaries. Moreover, it is not easy for small and medium enterprises to be optimistic for their rapid and stable development in the future.

Another issue is the link between SMEs as well as their links with other large enterprises through the establishment of associations, support funds, agreements on strategies and markets, and cooperation in production and distribution of goods and services. From an economic perspective, these links are vital, especially for small and medium enterprises, in order to be able to regulate the market needs, reduce negative competition and limit risks. The expression "business must have partners, trading must have associations" shows the need for associations of businessmen in the traditional Vietnamese society. However, associations tend to be unofficial and based only on close relationships, friends, and neighbors etc. not on the economic and functional relations as in modern societies. Until now, the degree of cooperation among small and medium enterprises is not only limited but is of similar nature to those in traditional societies.

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<sup>3</sup> Vu Quoc Tuan, "Making socioeconomic environment for the establishment and development of enterprises", in: Sociological Review (Vietnamese), No 4/1998.

Perhaps, the ability to create associations in a systematic way only exists in large foreign invested enterprises. The major function of those systems is the distribution, rather than the production of goods. In addition, "*in this cooperation, small and medium enterprises often lose out economically due to unfair practices of large enterprises*".<sup>4</sup> The link between small and medium enterprises on the one side and large state-owned enterprises on the other may be more complicated. It is clear that as long as the government does not have a concrete mechanism to encourage, direct and control the links between enterprises, that such associations cannot actively facilitate the development of small and medium enterprises.

### **3. Conclusion**

The establishment and development of SMEs plays an important role in the industrialization process in Vietnam. It is also an inevitable dimension of socioeconomic development in our country at the moment. However, apart from some initial encouraging developments, the operation of SMEs in recent years has revealed many shortcomings and difficulties of both objective and subjective natures.

For a steady development of SMEs, besides the perfection and implementation of government policies, economic solutions, technological development, a reform of the legal framework, and social acceptance of SMEs are also necessary conditions for their successful future development.

Basically, economic laws can be applied in many different countries. However, the effective application of such laws depend heavily on the cultural, social and political characteristics of each country. Therefore, in order to lay the ground for policies that meet the above-mentioned requirements, other concerned social aspects relating to SMEs are also important and need to be focused on so that they can be fully understood.

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<sup>4</sup> Duong Ba Phuong, "Improving medium and small enterprises in rural areas in progress of industrialization and switching to market economics", Hanoi: Agricultural Publishing House, 1996: 196.

# PRIVATE ENTREPRENEURSHIP AND SOCIAL CHANGE IN TRANSITIONAL ECONOMIES

## THE SOCIOPOLITICAL IMPACT OF PRIVATE INDUSTRY IN VIETNAM - SIX THESES -

*Thomas Heberer/Arno Kohl*

### **1. Introduction**

In the late 1970s and 1980s, two different development approaches emerged in the socialist world. The Soviet Union and Eastern Europe<sup>1</sup> adopted an approach of radical political reform as a precondition of a successful economic reformation. A privatization program from above was initiated. Privatization from above means the legal change of the ownership structure of the state-owned sector.

In contrast, the Asian socialist countries of China and Vietnam followed their own gradualist path of economic changes without attempting to induce radical political reforms. The overall political goal was (and still is) to maintain political stability while promoting economic liberalization.<sup>2</sup> Without any blueprint for an extensive privatization of the state sector, the privatization process took place spontaneously by the early illegal founding of new small enterprises. This widespread privatization process leads to a fundamental social and political change from below, that was neither foreseen nor intended at the beginning of the reform. Its dynamics make this process almost uncontrollable.

### **2. Research design**

Since the economic, social and political subsystems of a society are interrelated, a fundamental change in one subsystem will cause changes in the other ones, too. Fundamental change refers to structural change, not merely to a technical one. Structural change occurs at a macro-level having an impact on the subsystems as a whole. In general, structural change in the economic, social and political subsystems is related to values, property rights, social stratification, emergence of a new or decline of an old elite, etc. Figure 1 presents schematically structural changes in all these subsystems and some causal relationships between them. As can be seen, sociopolitical change is a highly complex process that can hardly be analyzed in its entirety.

In Vietnam, the changes in the structure of property rights resulted among others in the resurrection of a private sector thus constituting a new economic elite of private entrepreneurs. New interest groups are formed in order to aggregate and articulate interests of new social groups like the entrepreneurs. These processes of change are accompanied by a change of the value system. The functions of institutions of the political system are changing in reaction to an ongoing marketization of the economic system. All of this constitutes a partial weakening of the economic and political power of the central government and thus political change.

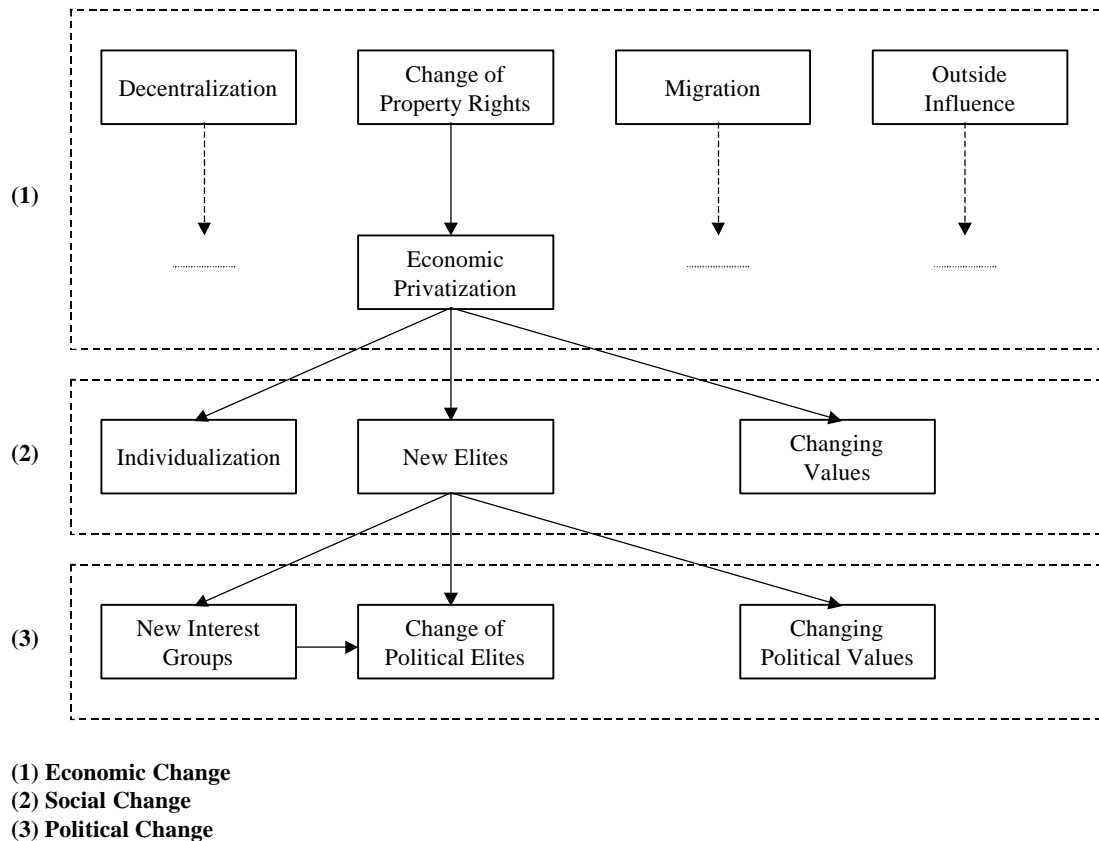
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<sup>1</sup> With the exception of Hungary.

<sup>2</sup> For a comparative analysis of the different reform strategies cf. Ha-Joon Chang/Nolan 1995. For a comparison of China and Vietnam see Naughton 1996.

Although economic studies on Vietnam are abundant, social scientists are slow in researching the sociopolitical consequences of the economic development. Especially the private entrepreneurs, one of the driving force of Vietnam's "economic miracle", escaped to a great extent the researchers' attention.

Figure 1: Structural Change in Vietnam



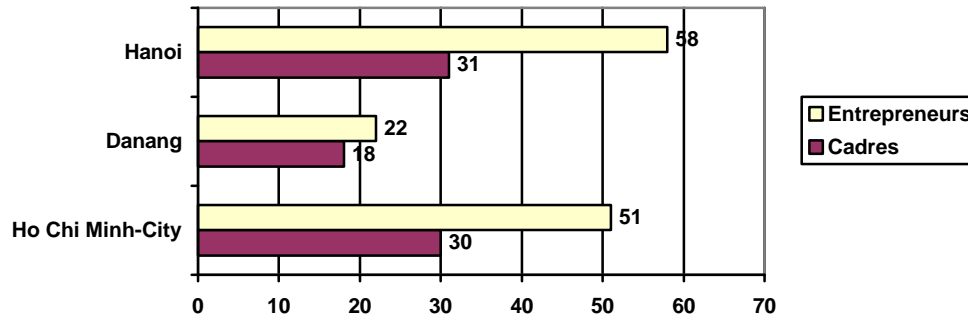
Therefore, in an empirical project on "The Private Economy in China and Vietnam and Its Economic, Social, and Political Consequences" we are analyzing comparatively the relationship between economic development and sociopolitical change in Asian transition countries. In China and Vietnam, our project focused on private industrial entrepreneurs and state cadres as two important social groups closely affected by the recent developments. In Vietnam, we concentrated on more developed geographical regions, since there the impact of the resurgence of the private sector is most visible. In 1996 and early 1997 we carried out surveys in Hanoi, Tien Son (Bac Giang), Danang, Duy Xuyen, Ho Chi Minh-City and Thu Duc. This paper presents some preliminary findings of our surveys in the urban regions of Hanoi, Danang and Ho Chi Minh-City.

The questionnaire for the entrepreneurs consisted of some 70 questions on economic, social and political topics. The first section of it was devoted to quantitative data on the enterprise (e.g., quantity of goods produced in 1995, turnover, taxes paid, number of workers). In the second section we asked for qualitative information on the operational status of the enterprise (e.g., external relationships such as business contacts to state-owned enterprises, internal relationships such as social insurance of the workers). Another section collected information about the personal characteristics of the entrepreneurs (e.g., age, education). In the largest section we posed questions on social as well as political issues (e.g., self-evaluation of status, opinion questions). A questionnaire took up to two hours and was followed by a discussion of the same length. A



questionnaire with some 20 questions was distributed to cadres. Figure 2 breaks down the responses by geographical region and respondents.

Figure 2: Surveyed Entrepreneurs and cadres by region



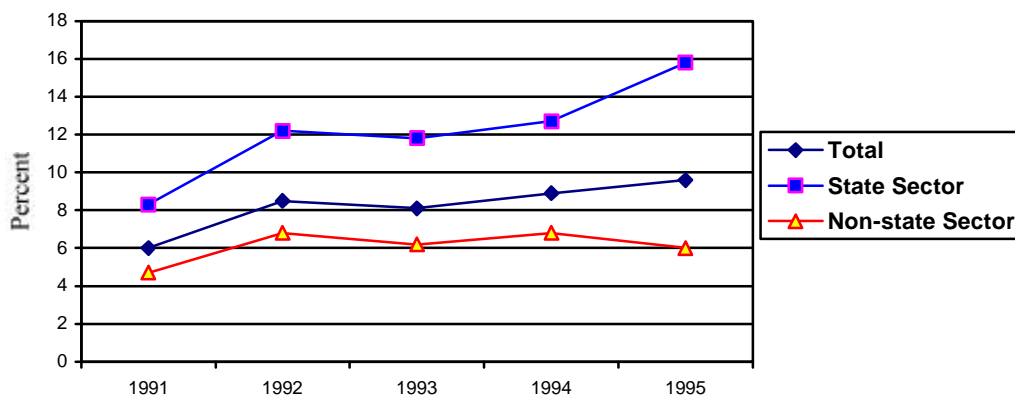
### 3. Preliminary Findings

Since data processing is still ongoing, the paper presents only preliminary results in form of these in order to give a rough idea of urban private entrepreneurs as a new social group and its political impact.

#### *Thesis 1: The Private economy has developed rapidly and plays an important role in today's Vietnamese economy*

Vietnam has made remarkable economic progress in the last ten years. Until 1989, Vietnam had to import rice in order to feed its population. A few years afterwards, the country became the world's third largest rice exporter behind Thailand and the USA. From 774.7% in 1986 the inflation rate dropped down to a modest 6% in June 1996. GDP growth rate rose from 3.25% per year during the period of 1987-90 to 8.2% per year in the period of 1991-95, indicating a high and continuous growth since introduction of doi moi in December 1986 (comp. figure 3). The average growth rate of industrial production was still higher: 13.3% for the period of 1991-95. The per-capita-income rose steadily to about 220 US-\$ in 1995.

Figure 3: Growth rate of GDP 1991-95



Source: General Statistical Office 1996b: 40.

One key factor of the success of doi moi is the resurrection of the private economic sector. It plays a vital role in the mixed Vietnamese economy, contributing 57.8% to the GDP in 1995. From

1988-93 the non-state economic sector created 5.4 million new jobs while the state sector slashed 1.1 million jobs in the same period. By merger, liquidation and ownership changes the number of State-owned enterprises (SOEs) was reduced to 6,500. In contrast, the private sector expanded rapidly. In 1988 in the industry alone 318 private enterprises and private-state joint ventures as well as about 320,000 individual businesses had been registered. Until 1995, the number climbed to 5,152 and 517,418 respectively (comp. table 1).

*Table 1: Number of registered industrial enterprises in the private sector*

	Number of private enterprises	Number of individual enterprises
1985	920	206,172
1988	318	318,557
1989	1,284	333,337
1990	770	376,930
1991	959	446,771
1992	1,144	368,000
1993	3,322	449,016
1994	4,909	493,046
1995	5,152	517,418

*Source: General Statistical Office 1996a: 280; General Statistical Office 1996b: 209.*

However, the official figures give only an incomplete picture of the actual situation. The conclusion of McCartney that "official Vietnamese data to 1991 can only be used in an indicative manner, that is, as little more than signs of possible or probable changes in the economy"<sup>3</sup> has still some validation. The actual extent of the private economic sector seems for several reasons to be much larger than officially admitted:

1. Many of the SOEs are in fact operating like private enterprises: in the last years a very widespread informal privatization of state property mainly through the managers of SOEs and administration cadres occurred.<sup>4</sup> The higher growth rate of the GDP in the state sector (cf. figure 3) is partly due to the fact that the figure includes the joint ventures with foreign companies.<sup>5</sup> Furthermore, the reduction of the number of SOEs from 1988 on is related mostly to small loss-making enterprises.
2. In official figures, the ailing collective sector and the dynamic private sector are counted together in the non-state sector (cf. figure 3). Due to this the share of the non-state economy of the national GDP decreased "mainly due to sharp decline of collective economy".<sup>6</sup>
3. Many private entrepreneurs have registered their firms either as state or collective enterprises in order to evade heavy taxation. Another reason is the official policy of promoting the development of the state economy or, as in Danang, of the collective sector.

<sup>3</sup> McCartney 1992: 5.

<sup>4</sup> For different ways of informal privatization see Kolko 1997: 53-63. Ironically, as the author points out, this kind of privatization is a major obstacle to a formal, i.e. legal privatization, that would strip the managers of the control of the SOEs.

<sup>5</sup> Le Dang Doanh 1996: 18. "98% of foreign joint ventures are currently with enterprises in the state sector", Suiwah Leung 1996: 3. For tricks to make SOEs suddenly appear profitable, see Kolko 1997: 57.

<sup>6</sup> Luu Bich Ho 1994: 185.

4. Impossible to estimate is the extent of the informal economy. Many of the registered enterprises grew out of the informal sector especially after 1992 due to the promulgation of a law on private enterprises and limited liability companies. According to Le Dang Doanh, the President of the Central Institute for Economic Management, over 1.1 million unregistered households were operating in 1996.<sup>7</sup>

Therefore in economic terms the development is heading rapidly in the direction of privatization and more market.<sup>8</sup>

***Thesis 2: Urban private entrepreneurs constitute a new social group clearly distinguished from other social groups in Vietnam***

Social groups can be distinguished by objective criteria such as level of income, occupation, etc., and by subjective criteria, e.g. group consciousness, self-evaluation with regard to social status, etc.

*a) Objective group characteristics*

Most entrepreneurs are in the middle ages. They established their enterprises after having several years of job experiences. Their previous occupation enabled many to develop a network of relations on which they partially rely in their business operations.

The educational level of the surveyed group is very high as compared to the entire population: 62.5% had finished high school against 4.5% of the national urban population according to the living standard's survey of 1992-93.<sup>9</sup>

The urban private entrepreneurs belong to the highest income groups in Vietnam today. At least 6% of the surveyed people had an annual income of over 200 million VND (US-\$ 18,182) in 1995. The largest group with 37% had an income of 21 to 200 million VND (US-\$ 1,909 to 18,182). Since income is a very sensitive problem, the actual figures may be even higher. In Hanoi per capita income was about US-\$ 245, in Danang US-\$ 161 and in Ho Chi Minh-City US-\$ 536 in 1994, according to a survey of the Vietnamese Institute of Sociology in Hanoi.<sup>10</sup>

Also the monthly expenses of the surveyed group were fairly high as compared to the entire urban population. Households instead of individuals are the basic unit of our calculation. Almost half of the households had expenses above 2 million VND (US-\$ 181) per month. The second largest group with 40% had expenses between 1 and 2 million VND. According to the living standards survey of 1992-93, on a national scale only 7% of the urban population had annual expenses of over 17 million VND.<sup>11</sup> Even if we consider the inflation rate between the three different years of the surveys the expenditures of the entrepreneurs' households are far above the average.

The property of the entrepreneurs is measured by the two categories of production means (e.g., fixed assets, capital) and family property (e.g., houses). Here, only the second category is of interest. 93.75% of the respondents owned at least one house for living. A comparatively high percentage of entrepreneurs (at least 34%) owned two or more houses. Again, this is a very sensitive issue. A survey of the National Center for Social Sciences and Humanities in Hanoi found that only 60% of the rich households lived in their own private houses in 1992.<sup>12</sup>

31% of the entrepreneurs' parents once had their own enterprise. A remarkable number of the entrepreneurs seem to spring off from the capitalist class and the petty bourgeoisie of

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<sup>7</sup> Le Dang Doanh 1996: 18, fn 3.

<sup>8</sup> In different regions this holds true even for landownership. For details, see the interesting study of Nguyen Tri Khiem 1996.

<sup>9</sup> State Planning Committee 1994.

<sup>10</sup> Tuong Lai 1996: 5.

<sup>11</sup> State Planning Committee 1994.

<sup>12</sup> Trinh Duy Luan 1993: 65.

pre-revolutionary South Vietnam. Even in Hanoi this percentage was as high as 20%. The reason might be that a second or informal economy operated in the socialist North before doi moi.

Social background was divided into the categories "occupational mobility of respondent" and "most recent occupation of respondent's father". Almost 57% of the entrepreneurs were employees, managers or cadres predominantly in state or collective-owned enterprises and in state institutions. This number was lower for the respondents' fathers: roughly 36% had previous experience as employee.

#### *b) Subjective group characteristics and group consciousness*

Although the respondents for obvious reasons did not want to speak of a class of entrepreneurs, they nevertheless emphasized the existence of a new social group who could be clearly distinguished from other social groups. For lack of a better term one respondent in Danang characterized the entrepreneurs as "a new social movement".<sup>13</sup>

Interestingly enough, when asked for the characteristics of this new group most respondents did not cite material wealth in the first place but their high educational level, special abilities and a certain state of mind. According to them, not everybody might become a successful entrepreneur; especially the peasants would lack the required abilities and flexibility of mind.<sup>14</sup>

Their self-consciousness is further reflected in their image of the Vietnamese society. Asked to view 10 different social groups and to pinpoint their own position in a ten-graded scaling scheme concerning economic ability, social prestige and political status, they regarded themselves clearly as the most efficient and economic productive group. But in their self-assessment, neither the social nor the political status did correspond to their self-grading in the economic field. Obviously, the different self-grading in terms of economy, society and politics can lead to discontent with the status quo. In fact, some respondents accused the Communist Party of Vietnam (CPV) not to honour the entrepreneurs' contributions to the Vietnamese development.

Obviously, with 41% a relative high percentage of the surveyed entrepreneurs were self-confident enough to regard themselves as something like a shining example for the society.

Frequent exchanges of experiences between the entrepreneurs do strengthen their group consciousness. At least 25% met weekly and 47% held several discussions per month with other entrepreneurs.

### ***Thesis 3: With resurrection of the private sector, new interest groups are emerging who influence the political process***

In general, interest groups aggregate, articulate and realize the interests of a social subgroup through an association. In so far as they make an input into the society that influences either the output (i.e., political decision-making) or the outcome (i.e., results of implementation of a political decision), these interest groups have a political impact. The partial withdrawal of the state from the economic area during the reform process in general and the privatization process in particular, gives interest groups more room to maneuver thus increasing their autonomy.

In the private sector the demand for a non-governmental or at least semi-governmental association truly representing the interests of the private entrepreneurs seems to be very high. 25% of the surveyed entrepreneurs complained that the local administration did not consider their interests.

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<sup>13</sup> For a Vietnamese view cf. Tran Phuc Thang 1994: 6-7 who calls this group frankly "the Vietnamese bourgeoisie". He predicts: "It will develop step by step, define its ideology, and then have its voice on the political scene. However, ... the bourgeoisie in our country cannot hold key economic positions, and control sensitive sectors of the economy, it cannot govern our country's economy". Tuong Lai, the former director of the Institute of Sociology in Hanoi, defines the entrepreneurs as part of a new middle class; Tuong Lai 1996: 14.

<sup>14</sup> In China, the other successful Asian transition economy, the most successful entrepreneurs were of peasant origin. Compare Heberer/Taubmann 1998; Heberer 1999.

Even more entrepreneurs (77%) thought the government's policy toward the private economy was poorly implemented. Almost the same number subscribed to the view that today too many restrictions hindered the development of the private sector. Out of this discontent arises the need for entrepreneurial interest groups. Accordingly, 76% of the surveyed entrepreneurs saw the founding of non-governmental business associations as absolutely necessary.

Asked for the functional purposes of such organizations, contacts to the administration in one or another way ranked at the first and third place of the responses. About 87% showed an interest in cooperation between entrepreneurs and the administration. 45% wanted a representative body of their interests toward the bureaucracy.

The demand for organized expression of the entrepreneurs' interests leads to a relative high founding rate of business and professional associations. The specific hybrid character of the socialist market economy forces these organizations to follow a double-strategy: Although intended as interest groups of the private sector they also have SOEs as members. Thus they can avoid the accusation to be a mere pressure group of exploitive capitalists. Furthermore they can use the network of relations between SOEs and the administration to enhance their own interests.

One case in point was the Hanoi Business Club whose members came to a considerable portion from the state sector. To a long list of consultants belonged minister Phan Van Tiem, Chairman of the Enterprise Reform Committee of the Vietnamese government. Affiliated with the Club was the Center of Economic Training that organized training courses in market economy for administrative and party cadres.

***Thesis 4: Despite marked political interests there are no legal ways for the entrepreneurs to engage in politics***

Entrepreneurs showed pronounced interest in politics. 67% desired an active role in discussing the government's economic policies, a rather understandable wish since the CPV and the government still define the limits of entrepreneurial activity. Nowadays, the entrepreneurs are self-confident enough to subscribe to the view that politics is not a playground for the Communist Party alone. Almost 35% thought entrepreneurs should "care" for politics.

In principle, there are only two ways to be active in formal Vietnamese politics: either through membership in the CPV or as delegate of the People's Councils at the different administrative levels. In fact, both ways are almost blocked for private entrepreneurs. Although not stated officially, the CPV does not grant membership to such "capitalists", at least not at central or provincial level.

At province level almost no entrepreneurs are represented in the People's Councils. The few who became delegates have only very limited *direct* political influence. Even as a delegate their actions depend on the consent of the CPV closely supervising all "democratic" institutions in Vietnam. Therefore, some of the respondents label the Councils a "political comedy" or "comical opera". Nevertheless, as delegates the entrepreneurs can get access to important information and to influential people thus enabling them to promote their specific interests (albeit in an *indirect* fashion).

Some of the entrepreneurs in Danang and Ho Chi Minh-City thought that the fundamental economic changes in present-day Vietnam will necessarily lead to the ultimate success of a capitalist system and a multi-party state "like in Western countries" as one respondent noted. In a capitalist Vietnam, one party would represent the private entrepreneurs' interests. One entrepreneur called this process a "silent capitalist revolution" coming about as a natural consequence of the fast growing private sector. By the sheer force of their number and their economic relevance, the group of private as well as individual entrepreneurs would slowly drive Vietnam towards that revolution. One entrepreneur commented: "If the Asian or the Vietnamese people want to make a revolution, they are working

beneath the surface, in a calm manner. It is not in the open like the Europeans in Eastern Europe and the Soviet Union". In the mind of these entrepreneurs socialism and market economy (i.e., capitalism) are mutual exclusive thus making a combination of both in form of the officially propagated hybrid socialist market economy impossible.

***Thesis 5: The political power structure at the local level is changing under the impact of the privatization process***

The economic success and the wealth of the entrepreneurs erode the power of the party as well as of the government at the local level. On the one hand, the entrepreneurs need political protection in a complex political environment without a clear uncompromising commitment to the promotion of the private sector. Furthermore, since the administration is still an important actor in the economy despite the introduction of a market mechanism, the entrepreneurs seek a close relationship to the bureaucracy. Both, protection and improved relations can be gained by ways of corruption and by a close personal relationship with influential people. Accordingly 91% of the surveyed entrepreneurs regarded a network of personal relations as important for business operations. The Vietnamese call the desired protection "umbrella" (o du).

In this manner entrepreneurs in fact exert power, influencing economic and political decision-making to a certain extent.

On the other hand, administrative and party cadres strive to have a share in the wealth created by the private sector. Either they engage themselves (or their relatives) in some kind of private business or they try to get some "donations" from the entrepreneurs in exchange for protection and access to information, needed state assets for production purposes, etc. 96% of the respondents had given some kind of donation to the local administration in 1995. In 40% of the cases the cadres had directly asked **for the** money. In one extreme case an entrepreneur in Ho Chi Minh-City complained bitterly about the cadres approaching him 70 (!) times in 1995. One out of four respondents admitted frankly to try to improve their relations to the administration by this way.

The engagement of party and administrative cadres in the private economy seems to be widespread although due to its often illegal or at least politically not desired nature it is difficult to estimate its extent. E.g., in Danang 1/3 of the official registered limited liability companies belonged to members of the CPV, despite the fact that their direct engagement in private business activities is prohibited by the party. Their "capitalist" activities set in motion a bottom-up oriented process of change, promoting values and behavior that are more suitable to a market-oriented economy. Their political and economic interests and objectives run counter to the original intentions of the Communist Party. In this regard the Vietnamese political system is actually changing at the local level.

***Thesis 6: Introduction of market mechanisms brings about a change of the value system***

The rapid economic development leads to a re-evaluation of values primarily connected with economic behavior but not necessarily confined to the economic area alone. The re-evaluation of entrepreneurship, wealth, earning money, luxury etc. breaks with the past socialist negative images and norms. To cite but few examples: 79% of the entrepreneurs took the difference between rich and poor in a society for granted. 88% subscribed to the market economy a positive effect on the economic development of Vietnam.

Even the surveyed group of administration cadres held almost the same views as the entrepreneurs in the cited examples. Almost all cadres proposed state support for further development of the private sector. A considerable portion of the cadres would like to engage themselves in the private sector provided they had the necessary capital to do so. Likewise, a survey of the Vietnamese Institute of Psychology conducted in Hanoi in 1992 demonstrated that 23% of the surveyed cadres intended to engage in some kind of private economic activities.

Changes in the value system are also reflected in the increasing stress of one's own abilities. The most cited reason for becoming an entrepreneur is the wish for self-employment. At third place for the reasons follows no opportunities to demonstrate their talent at the previous workplace. Out of nine factors determining economic success, one's own abilities ranked at the first place. This trend towards individualization of the value system finds also expression in the fact that 30% of the entrepreneurs regard pursuing their personal happiness as a very important objective in their life.<sup>15</sup>

#### **4. Conclusion**

As illustrated above a certain pattern of development emerged in Vietnam in the last years. The privatization process generated an evolutionary process that started predominantly spontaneously from the economic subsystem and led to structural changes in the social and political subsystems. One of the driving forces of change are - voluntarily or not - the private entrepreneurs. Their different behavior and values affect their social environment where they contribute to or even generate change in behavior and values of the non-entrepreneurial segments of the population. Since this occurs at many places simultaneously, the process of change at micro-level intensifies and develops its own apparently uncontrollable dynamics.

Insofar as the private entrepreneurs can be clearly distinguished from other social groups by subjective criteria (e.g., a new life style, a new system of values, different status symbols) as well as objective criteria (e.g., group consciousness, self-confidence, social capital), a new social group (stratum) emerges and alters the social stratification in Vietnam in a significant way. Especially the successful entrepreneurs constitute a highly self-confident group with a marked group consciousness. They see themselves as more thoughtful, better educated, and more flexible than the less successful entrepreneurs and the people in general. Some regard it to be natural that the introduction of market mechanisms does change the structure of the society, leading to the formation of different social groups and resulting in the long run in a capitalist multi-party system. They see socialism and market economy as not compatible.

The economic power and the steady expansion of the private sector put pressure on the political system, leading to political change at the local level. The local political elite of cadres and the new economic elite of entrepreneurs are often driven together by their respective interests; sometimes both elites may even merge.

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<sup>15</sup> Cf. the results of Vietnamese surveys, e.g. Nguyen Quang Uan 1996: 43-44.

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