

ACTIVITIES OF THE INFORMAL SECTOR AND BUSINESS CLIMATE IN VIETNAM

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1. Informal sector in Vietnam

Vietnam's economic growth in recent years has led to remarkable development of the informal sector and its share in the GDP.

Table 1: Informal sector share in the GDP

Year	2004	2005	2006	2007	2008
Informal sector share (%)	14.9	15.8	16.3	15.5	15.7

Source: World Bank, *Share of the informal sector in the Vietnam's GDP*

According to a WB estimate, with an informal sector that accounts for 15.5% of the GDP, Vietnam ranks among the most progressive countries in Asia besides China and Singapore (both 13.1% of the GDP), and Japan (11.3%). It's worth noting that the informal sector has both legal and illegal activities whose contributions to the GDP can't be calculated exactly and tax payment can't be collected. These activities include transactions in cash without invoices, or gambling and drug smuggling, etc.

This means that it's difficult to measure exactly activities in this sector. It exists and develops in the darkness with many advantages. Firstly, it avoids all taxes, especially the income tax. Secondly, it pays no social security allowances. Thirdly, it saves a lot of money by avoiding regulations on environmental protection, labor safety, and intellectual property, etc.

At a higher level, activities in the informal sector are products of elements that can hinder structurally targets of socioeconomic development in

Vietnam. Development of this sector shows a business climate including too many regulation and ineffective enforcement of laws. It also means that legal regulations are not compulsory, and therefore, they stop being effectively regulatory instruments for the government.

However perfect regulations and statutes are, they can be eroded by activities of the informal sector because these activities create unfair advantages for law-breaking companies and distort allocation of resources. In another aspect, if regulations are unfair or enforced unjustly, activities of the informal sector could be seen as an effective reaction by disadvantaged companies that aim at recovering their position in the playing ground.

Whatever the directions the realities take, the price for the activities of the informal sector is rather high. For example, concerns in this sector can hardly cooperate with either local or foreign partners. Chances of development for Vietnam are increasingly linked with globalization. Transparent activities will affect greatly the corporate competitiveness when facing opportunities and challenges of the international integration.

According to an estimate by the World Bank, investment in Vietnam should be equal to 30% of the GDP by 2010 increasing by 5% over the 1990s while the average productivity should grow by over 40%. To achieve these targets, the Government should encourage the private sector, especially the formal one, to contribute more to the economic growth. This requires more improvements in the business climate.

From 1993 on, the informal sector has been internationally defined as "part of the economy comprising concerns that have no legal entity and license and are not regulated by Companies Law." These concerns may be family businesses, unregistered SMEs, or self-employed persons.

A report by the IRD on the Vietnamese informal sector notes that concerns in this sector are ready to register their business in order to operate according to the Companies Law because as informal concerns they can't get access to financial institutions and bank loans (only 4% of such concerns in HCMC, and 6% in Hanoi, secured bank loans), and secure no land for their factories in the two cities where the real estate prices are very high and competition is very fierce.

Apparently, Vietnam should improve its business climate, develop the private sector and encourage informal concerns to get formalized in its effort to achieve its development targets.

This article is based on opinions on the business climate gathered from private and state-owned concerns. The following are their opinions on main obstacles in the informal sector.

Results of the survey allow some remarks on the Vietnamese business climate:

(1) A level playing ground is a basis for development of the informal sector: The sector develops well in Vietnam because companies have different ownership and sizes and receive unfair treatment. SMEs usually meet with difficulties in securing bank loans, land and other essential resources. The size also affects their informality: small companies usually conduct informal activities.

(2) Price for informal activities: Such activities don't help reduce corporate overheads. On the contrary, they have to spend more time, money and energy dealing with regulations and inspections;

and their indirect expenses are usually higher than the ones paid by companies in formal sectors.

(3) Lack of a level playing field distorts allocation of resources: There are many regulations that

Table 2: Main obstacles facing private and state-owned companies

State-owned companies		Private companies	
Obstacle	Considered as serious (%)	Obstacles	Considered as serious (%)
1. Unfair competition	64	1. Unfair competition	61
2. High tax rate	62	2. Poor demand	56
3. Changing policies	57	3. High tax rate	55
4. Poor demand	54	4. Access to sources of finance	48
5. Inconsistent policies	53	5. Inconsistent policies	42
6. Red tape	52	6. Changing policies	42
7. Macroeconomic instability	47	7. Discriminatory treatment	42
8. Lack of knowledge of marketing	47	8. Red tape	40
9. Managerial skill	42	9. Macroeconomic instability	37
10. Cost of granted capital	35	10. Financial costs	34

Source: Stoyan Tenev, Amada Carlier, Omar Chaudry & Nguyễn Quỳnh Trang (2003) *Hoạt động không chính thức ở Việt Nam* (Informal activities in Vietnam).

control access for companies of different sectors to resources such as finance and land. The public sector can get bigger loans. As for the land, state-owned companies employ pieces of land that are bigger than what they need in both long and short terms. This situation requires more improvements in the business climate to maintain possibility of economic growth. The more transparent the eco-

nomic activities are, the more benefits are brought about. This ideal can be achieved by getting rid of overlapping regulations, making laws more reasonable and effective, and ensuring a level playing field.

Table 3: Average time spent on dealing with laws by ownership and size

Ownership	Median	Standard deviation	Minimum	Maximum
Public	21	18	1	90
Private	30	43	1	360
Workforce	24	19	1	90
- From 25 to 100	35	63	2	360
- From 101 to 500	21	20	3	75
- Over 500	35	45	1	168

Source: Stogan Tenev, Amada Carlier, Omar Chaudry & Nguyễn Quỳnh Trang (2003) *Hoạt động không chính thức ở Việt Nam* (Informal activities in Vietnam).

2. Some suggested measures to improve the business climate

Firstly, the laws must be more reasonable: Laws and regulations must be appropriate to interests of everybody and classes in order to enforce fully the role of the state in management. Biased opinions in the administrative management must be corrected.

Secondly, Ability to enforce the laws and administrative functions must be beefed up, and responsibilities of public services must be clarified. Thirdly, the public sector must be reformed in order to create a level playing field. At present, opinions biased against private companies and SMEs still exist in the administrative machinery. Such prejudices can be eliminated by a stronger reform in the public sector and a broader access to capital and land open to private companies.

Thirdly, problems with relations between supply and demand must be dealt with properly in order to offer more opportunities to get access to the financial resource. Equitization and privatization can provide such opportunities, thereby establishing a level playing field.

Commercial banks should enhance their ability to identify risks in order to handle requests for loans based on mortgaged assets and feasibility of borrower's business plans. Private companies must standardize the economic activities and improve their managerial skills.

Fifthly, there must be equal opportunities to secure land for all companies. Private companies usually meet with difficulties in securing bank loans because they lack assets to mortgage to the banks. Regarding the problem from a broader aspect, we see that it's the poor administration of the land stock that forces private companies to suffer higher costs for the land use rights.

Cost of changing land use purpose must be cut in order to help private companies get legal forms appropriate to their development plans and business strategies.

The private sector will be the principal force of economic development in Vietnam allowing the government to achieve its socioeconomic targets. Laws and regulations that are appropriate to the market economy and able to stimulate the private sector to develop will bring about socioeconomic benefits for the whole economy■

Reference

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