DEVELOPING THE PRIVATE SECTOR BY ENHANCING CROWDING-OUT EFFECTS AND REDUCING THE CROWDING-IN EFFECTS

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The private sector of Vietnam, which is represented most by non-public companies, has evolved proactively and extensively, generating a lot of jobs for local workforce. However, Most of them are in labor-intensive industries with low added value, small size and poor entrepreneurship (i.e. business expertise, information transparency, and managerial skills). Thus, the private sector is facing challenges while it is expected to push up Vietnam's economic development. This can be excused that natural-historical advantages, fiscal policies, monetary policies, and the formation of business clusters seem to bias towards state-owned and foreign-run enterprises, which produces crowding-out effects on the private sector. In order for the private sector to be a driving force in the national economic development, it is needed to determine the role of the public sector in promoting efficiency of public investments with a view to bringing in the crowding-in effect on the private sector and gradually reducing the crowding-out effect of the state-owned sector on the private one.

Keywords: private sector, non-public enterprises, crowding-out effect, crowding-in effect

1. Introduction

The document of the VCP 11th Congress defines that the private sector is the primary driving force of the whole economy. Table 1 shows that the size of non-public sectors have been rapidly evolving in terms of labor force, number of enterprises, revenue, and investments; yet its pre-tax profit and share in budget income in 2008 only accounted for 16.6% and 30.8% respectively. In fact, the non-public sectors, over the past decade, has just developed extensively and helped create a considerable number of new jobs. This can be explained by the fact that the majority of such enterprises are less capital-intensive. Nonetheless, their business performance proves that they are just small- and medium-sized enterprises. Thus, it is extremely hard for the non-public sectors to be the driving force of the economy as a whole.

This paper is to investigate reasons causing difficulties for non-public sectors against the background of their potentials. Some related theories will be reviewed to define factors affecting the development of such sectors and data about these factors are also analyzed so as to raise some solutions to the development of the private sector which is expected to be the primary driving force of the Vietnam's economic growth.

2. Factors affecting the development of non-public sector

Porter (1990) and Hausmann- Rodrik- Velasco (Todaro, 2009) propose that factors affecting the performance of non-public sectors are identical to those of other sectors. They interpret factors that encourage or discourage private investment in terms of: natural and historical advantages (i.e. the inheritance of natural resources, strategic ge-

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Table 1: Indicators reflecting sizes of enterprises in 2000 and 2008

Indicator	Labor		Enterprise		Revenue		Investment		Asset value	
Years / Sectors	*2000*	*2008*	*2000*	*2008*	*2000*	*2008*	*2000*	*2008*	*2000*	*2008*
TOTAL	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%
State-owned enterprises	59%	24%	14%	2%	55%	31%	67%	47%	56%	48%
Non-public enterprises	29%	53%	83%	95%	25%	47%	10%	35%	8%	31%
Foreign-invested enterprises	12%	23%	4%	3%	20%	21%	23%	18%	36%	21%

Source: Calculations based on the data of GSO in 2000 & 2008

ographic location, or entrepreneurship accumulated in the past, etc.), macroeconomic factors (including fiscal policies, monetary policies, and institutional factors that facilitate the establishment of a better business climate and higher productivity), and microeconomic factors including inputs (infrastructures, transportation and communication network, financial infrastructure, human resource, administrative infrastructure, corporate competitive edges), development of clusters of industries, and the information feedback rate of enterprises. The crowding out, as Mankiw (2009) put it, originates from excessive investments in the public sector and these investments are slow to produce results and lead to a reduction in sources of capital available for the private sector. According to Economist's View (2008), if public investments are efficient enough, they can reduce social transaction costs and thereby creating the crowding in, that is, public investments will help increase the private investment.

3. Data collation and methodology

The database are collected from the General Statistical Office (GSO), the World Bank (WB), the Provincial Competitiveness Index (PCI), the Transparency International (TI), and the WEF Current Competitiveness Index (CCI). The descriptive statistics is employed to evaluate the sectors in light of given aspects; and the comparative statistics is used for estimating the crowding-out effect of the public sector upon the non-public enterprises.

4. The performance of non-public sector

Figure 1 shows that the private sector, in terms of revenue and number of enterprises, is kind of proactive and dynamic, employing over 50% of the workforce of the enterprise sector. Yet, the capital amount injected into the sector is just around 25% of the gross capital of the enterprises. Whilst, the public sector is still a dearly beloved child provided with most of the gross investment. This means that investment in the private sector generates more income, sales and employments than that in the public one.

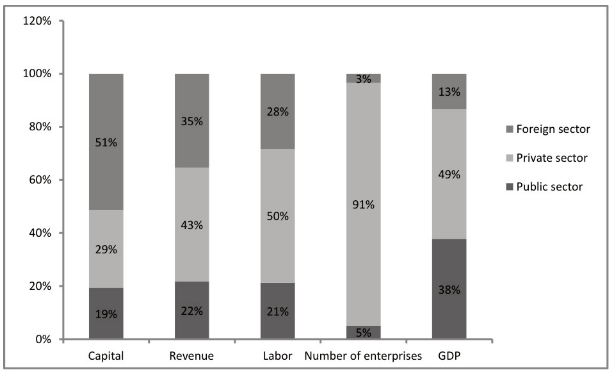

Figure 1: The percentage of capital, revenue, labor, the number of enterprises, and GDP of each sector in 2000 – 2007

Source: Authors' calculations based on GSO data in 2000 – 2007

The non-public sector is also superior to the public one in terms of industrial production. If the share of the non-public sector in industrial output (based on the real price) in 1995 was just half as much as that of the public one, it rocketed twice as much as that of the public one in 2009 (GSO, 1995 – 2009). This is to say, the non-public sector can become the driving force of the industrialization in time to come, provided that the crowding-out effect is reduced and the crowding-in effect of public investment is boosted.

Besides, our calculations based on GSO data (2009) shoe that the investment structure differs over three sectors. The non-public sector mainly concentrates on short-term businesses and services provision, such as retailing, restaurants and hotels, and realties, etc. The public sector invests in capital-intensive fields, i.e. transportation and infrastructural facilities. Foreign–invested enterprises have a strong desire for import substitute industries; yet it then turns to the export-oriented ones and recently the real estate brokerage.

Furthermore, the capacity of approaching intensively and disclosing information of private enterprises is rather limited due to the low educational level and poor administration competence.

Firstly, education and skills of managers of private enterprises are low. The number of managers of private enterprisers with a tertiary degree just accounts for 0.18%, and those with a high school degree or lower make up 4.36% (GSO, 2007). Around 41.88% of enterpriser managers have not attended any course in business; and some 24.61% have no knowledge of foreign languages (Porter & the Central Institute for Economic Management, 2010).

Secondly, business administration and transparency are poor. Majority senior managers of private enterprises are relatives of owners; and the disclosure of information by public-held companies is worrying investors. The Korean Institute for Industrial Policy Study on National Competitiveness in 2008 – 2009 concluded that Vietnam was behind all other Southeast Asian countries in business development index (Porter & CIEM, 2010).

5. Crowding-out factors affecting the development of non-public sector

a. Historical factors:

The economic development of a country comes from its historical background. The market economy and the private sector have just come into being and developed since the first half of the 1980s. They took shape when Vietnam moved from the centrally-planned mechanism to the socialism-oriented market economy. And thus, while the state-owned enterprises are still playing a leading role in the transitional period, the non-public sector is bound to aim at fields of service and small-sized production in market niches. In addition, the institutional factor, in a long time, has underestimated the role of private enterprises, and thus the legal infrastructure for its operation was not perfect and strict enough. It is just after 1986 that the non-public sector comprising small enterprises that constitute the present private sector was officially recognized. And up to 1999 when the 1999 Companies Law came into effect as of Jan.01, 2000, the legal infrastructure for the private sector was officially established (Phạm Minh Chính & Vương Hoàng Quân, 2009).

b. Natural conditions:

Vietnam is located in the heart of Asia, bridging China and other countries in the South East Asia. With a coastline of 3,260 km long, Vietnam possesses potentials for tourism, shipbuilding and other marine industries, which are mainly run by state-owned enterprises thanks to governmental privileges. Non-public enterprises cannot make use of these advantages, yet join in intermediate phases such as tour operations, inshore fishing, freighting from ports to warehouses. Besides, a long coastline, although partly facilitating agricultural production, can menace the agricultural production due to climate changes as rendered in the 2009 conference in Copenhagen.

Over the past three decades, economic growth depended much on the exploitation of natural resources, which is mainly executed by the state-owned enterprises. The private sector could hardly join in this field; or in other words, they cannot benefit from such the national resources due to the crowding-out effect from the public sector and the foreign one, which originates from institutional factors and shows a bias against the private sector in the access to natural resources. Besides, if a private enterprise would like to participate in this field, it must hold a large amount of working capital. Yet in fact, sources of capital from bank or saving institutions are not much open to small- and medium-sized enterprises.

c. Crowding-out effect from macroeconomic policies:

- Fiscal policies: Vietnam's budget income, according to Economist Intelligence Unit, is ranked rather high, around 27% of GDP over the period 2004 – 2007 on average compared with 2.7% in China, 2.9% in Malaysia, and 5.8% in the Philippines. Three quarters of such income come from four main sources, namely VAT (25%), crude oil (20%), corporate income taxes (15%), and customs duties (15%). Apparently, the contribution from enterprises to the national budget is quite humble, just 15%; and of that, the non-public enterprises makes up around 30%. It is meant that the contribution of the non-public enterprises to the budget is the lowest within the enterprise sector. This is to say, developing private enterprises, in both long and short run, is to deal with the employment in the whole economy; and the contribution to state budget still have to count on the performance of all sectors.

With regard to budget expenditures, there are two principal categories: investment in development projects (some 27.48%) and socioeconomic development (52.26%). Some 91% of the former is turned into working capital whose destination is usually state-owned enterprises in form of annual additional capital (GSO, 2008). In other words, the public sector enjoys 25% of national budget expenditure in form of appointed credit (loans supplied according to directives from the government), while the private sector must rely on its available capital or bank loans which are bound up with an extremely stringent procedure. Such the two different approaches to capital resources of the public sector and the non-public one have reflected a fact that the fiscal policy biases in favor of the state-owned enterprises when increasing public expenditure on industrialization. Yet in fact, the efficiency of such the government's dearly beloved child is not high as expected. As Chính & Hoàng (2009) put it, the number of state-owned enterprises reduced by half in the past two decades through liquidation. They held 53 to 67 percent of the capital amount of the enterprise sector yet just accounted for 37 to 39 percent of the GDP and employ around 4.4% of the working population. Whilst, the number of private enterprises, also in the two recent decades, has been multiplied by 200 times; and in 2008 alone when Vietnam was weathering the world financial crisis, the number of private enterprises still increased by 27.4% and the registered capital also itched up by 28% compared with the previous year.

- Monetary policies: The loose monetary policy in 2004 – 2009 has produced an annual credit growth of 37%. Yet, the approach to credit loans is just eased off for state-owned enterprises and thereby generating a crowding-out effect on and barriers to entry to private ones because the market interest rate, although not in the anti-inflation conditions, still reaches a high; and the access to bank loans by small- and medium-sized enterprises is limited for lack of assets for mortgaging, forcing them to resort to their available capital and loans of high interest rates from black markets. Accordingly, private enterprises often invest in niche and small markets with obsolete technologies.

Since the second quarter of 2008 till now, the government has tightened the monetary policy with a view to curbing inflation and beefed up its macroeconomic stabilizing policy in 2011 by setting a high interest rate ranging from 16 to 18 percent. As a result, opportunities to get access to short-term loans of non-public enterprises seem far beyond their reach; and the risk of bankruptcy is imminent and inevitable if the enterprise is not competent enough. Meanwhile, the state-owned enterprises are just affected by investment constraints.

c. Policies on establishment of industrial clusters

So far, the government has been investing a lot in establishment of both foreign and domestic industrial clusters such as clusters of automobile, high-tech, and shipbuilding industries; yet the efficiency is not high as expected, and the concentrative investment in such the clusters may set up obstacles for other enterprises under the crowding-out effect. The crowding-in effect on the non-public enterprises, whilst, cannot work much effectively. The birth of state-owned groups consumes a treasure of capital; yet their performance is indeed not high as expected. In other words, state-owned enterprises, under the sponsorship of the government, have more chance to grasp huge volumes of capital, while small-sized private enterprises hardly compete with state-owned ones for the access to credit and other resources (Chính & Hoàng, 2009).

d. Institutional factors:

Market institutions at service of newly-established enterprises and other constraints can hinder the operation of non-public enterprises. Although the legal framework is also improved, with the CCI ranked 53rd in 2009, most of non-public enterprises must spend some 10% of their revenue on informal charges as was rendered by PCI 2009 Report. The 2009 PCI also points out that more than 50% of enterprises must pay commissions to win contracts, causing enterprises, especially non-public ones, to suffer higher transaction costs. (Figure 3)

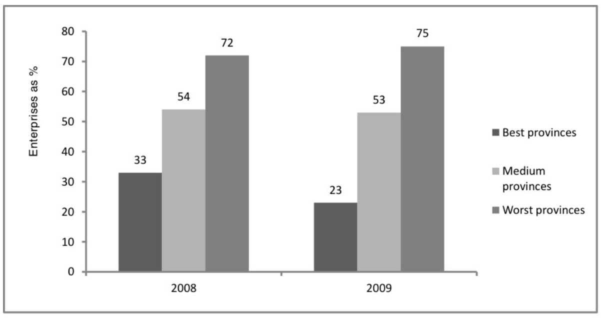

Figure 3: The percentage of enterprises paying commissions to win governmental contracts

Source: PCI 2009

The effectiveness of Vietnam's administrative system is mediocre and can restrain the growth of non-public enterprises. This can be proven by the fact that the policy transparency index is placed 45th, waste in governmental expenditures ranked 37th, and impartiality in the governmental decisions placed 34th (CCI, 2009). High degree of delegation of rights is also one of reasons causing the dispersion of resources among central and local bodies and lack of unanimity in execution of policies and decisions (Porter & CIEM, 2010).

In addition, the accountability of competent authorities has not satisfied the public in general and non-public enterprises in particular. The government has not actually encouraged non-public enterprises to raise their voice and inspect the execution of policies. Compared to China, the voice and accountability index of Vietnam is a little bit higher; yet much more adverse as compared to other countries in the region. Expressed in percentage, Vietnam's index is 6.7%, China 5.8%, and other countries in the region ranging from 20 to 60 percent (Porter & CIEM, 2010).

6. Research findings

The crowding-out effect on the non-public sector originates from many different factors. The fiscal policy in favor of state-owned enterprises in terms of supply of capital has kept non-public ones away from enjoying national advantages by erecting barriers to their entry. The loose monetary policy has helped the public sector expand its size, yet impossibly quenched a thirst for capital and even hindered the access of non-public enterprises to formal credit; and the non-public sector has to suffer a lot when the government executes the loose monetary policy by means of interest rate to weather inflation. Majority of enterprises living on natural resources and national advantages are state-owned or foreign-run ones; and the latter just undertake intermediate and labor-intensive services with low added value. Last but not least, the poor accountability and transparency of the institutions, although improved, still generates numerous informal charges for the private sector.

7. Policy implementations

Firstly, it is necessary to confirm that the public sector plays a vital role in supporting the development of other sectors in the economy. Truly speaking, the non-public sector is very proactive and creative; and their poor performance is due to lack of capital, technologies, and industrial cluster zoning programs. Thus, in zoning business clusters, it is needed to take the private sector into account and work out a competitive tendering mechanism concerning fields that the state-owned ones need not take care.

Secondly, the fiscal policy must pay proper attention to non-public enterprises as per their capacity of creating jobs and income and increasing industrial values. State-owned enterprises should not be considered as dominant in all industries because this approach may cause a crowding-out effect on other economic sectors, such as barriers to entry of private enterprises. Besides, infrastructural facilities built by state-owned enterprises needs expediting with a view to helping non-public ones reduce transaction costs.

Thirdly, the open monetary policy must aim at creating a fair and equal competitive climate and access to formal credit amongst economic sectors. Goals of policy goals must involve in the efficiency of business orientation instead of discriminatory rules. Moreover, when employing monetary policies to fight against inflation, it is also needed to attend to the loose monetary policy concerning taxes in order for the private sector to weather the high interest rate.

Fourthly, administrative reform must be secured to generate a healthier business climate and reduce informal charges as well as help the private sector cut down its transaction costs and enhance its access to information related to their business.

Last but not least, when zoning industrial clusters, policies, in addition to cares for state-owned and foreign-invested enterprises, need attend to the business climate of non-public ones as well■

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