



Removing obstacles for the private sector to become a driving force in economic growth

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Abstract

In most nations private sectors are major contributor for their economic growth and prosperity. The private economic sector in Vietnam has been officially recognized since 1986. More than three decades since then this sector has been operating below its potential. Nowadays, the changing mindset of the Vietnamese government, coupled with policy adjustments, brings remarkable positive effects to the private sector's development. For the private sector to become a driving force of growth, the favorable institutional environment is needed. This study points out unfavorable factors preventing the private sector development such as incomplete formal rules, overlapping laws, discrimination between private and state sector, troublesome enforcement practices (not so competent civil servants, accompanied harassment and bribe). Basing on the analysis of the status of the private sector, some policy implications are proposed: firstly, the focus must be put on improvement of the enforcement characteristics of the institutional environment. Secondly, the government should support private businesses in their market expansion, encourage innovation and training entrepreneurs.

Key words: private sector, driving force of growth, pragmatism



1. Introduction

The Vietnamese private economic sector had been officially recognized since 1986 when DoiMoi policy adopted. More than three decades might be long enough for development of an economic sector if appropriate policies had implemented. Up to now the private sector in Vietnam has been operating below its potential. *De jure* the private sector in Vietnam has been treated equally with other economic sectors *de facto* there still are prejudices, discriminations, as well as inadequacies in the institutional environment. This paper examines the role of the private sector in development and its contribution to Vietnam's prosperity in order to make proposals for ensuring the private sector to become a driving force of economic growth.

2. Method

The purpose of this research is to point out factors that hinder the development of the private sector in Vietnam and make recommendations to improve the institutional environment ensuring the private sector to become a driving force for economic development. Therefore, we conduct a literature review on the role of the private sector in the mixed economy and successful cases in the region to form a research framework to make analysis of the development of the private economy in Vietnam. Basing on that the review of laws and decrees regarding doing business and their impacts on development of the private sector was made. Policy recommendations were formed on the findings of the work.

3. Research results

3.1 The role of the private sector in economic development

Most contemporary economies are mixed ones where markets and governments work together. In free market systems resource allocation, production, consumption and prices are determined by collective actions of individuals and organizations maximizing their benefits. Where the market mechanism is perfect, the resource allocation or output level will be efficient. Where markets fail to create a desirable level of output or resource allocation there government intervention is needed. Most economists agree on an importance of a government in the market economy. However, differences exist regarding the role of the government. According to classical economists, markets function best with minimal government interference, the role of governments is to ensure macroeconomic stability and effective exchange rates. According to interventionism, governments should intervene widely in economic activities by promoting selectively particular sectors. The third approach to the role of governments is market friendly one according to which governments should actively intervene more where markets operate inefficiently and less where markets work well. And the appropriate role of the government is to invest in human development, ensure competitive atmosphere for businesses, and maintain an open economy with stable macroeconomic environment. There is no evidence about the superiority of any one of the above mentioned approaches. However, the countries with rapid growth all show the flexibility and pragmatism of their policies. Depending on country and stage of development, the role of the private sector or the public sector may be more important than the other.

Definition of the private sector

“The private sector comprises private corporations, households and non-profit institutions serving households”, (OECD, 2008, p. 423). According to the Development Assistant Committee (DAC) of Organization for Economic and Co-operation Development (OECD), the private sector is the region where private ownership is an important element of economic activity, where markets and competition promote production, and where private initiatives and risks-taking activities are in motion.

Thus, the private sector includes all economic activities non in the public sector. Individuals and organizations in the private sector are profit-seeking regardless of their size, sector and place



of operation. The private sector also includes organizations serving the private sector as professional associations.

The role of the private sector

The private sector contributes to growth

In mixed economies, the role of the private sector for society's development is viewed differently. There is an argument that the unique responsibility of the business is to increase its profits (Friedman, 1970). Other arguments consider businesses as social organizations responsible for contributing to society's well-being (Brainard, 2006). Indeed, how the private sector contributes for society's prosperity largely depends on the institutional environment in a particular country. The private sector contributes for growth in countries possibly by their core activity (providing goods and services to meet consumer needs), by taking activities on behalf of the public sector, and by acting as a partner in investment projects.

The private sector is the job creator

Nowadays, job creation is one of the biggest challenges of countries. Every year there is a large number of new comers in labor markets, the public sector and state-owned enterprises cannot create enough new jobs for that people while the private sector can do it. Generally, the private sector is more advantageous in job creation and effective use of labor than the public one. When a labor surplus present private enterprises lay off workers while the public sector cannot do so due to political pressures. The private enterprises are profit seeking so they are continuously looking for ways to meet consumer and cut costs as more as possible. Taking profit opportunities, private enterprises hire workers and buy other inputs to supply goods and services. The quality of growth lies in quantity and quality of jobs created. The favorable investment environment will make enterprises more productive and thanks for that they can pay employees higher wages and invest more in training them. This creates positive effects on wages paid by other enterprises.

Other contributions of the private sector

The private sector contributes to the government revenue by paying various taxes. In most developing countries the majority of government tax revenues come from the private sector. Governments use tax revenue to finance healthcare, education, social security and other important expenditures. In many countries private sectors also contribute to growth by engaging in infrastructure creation, such as electricity, water supply, transport, telecommunication and waste treatment, in which governments would choose more efficient providers than providing it themselves. In fact, the private sector plays an important role in healthcare and education as well. The private sector contributes to growth by innovative mechanisms, funding research, cost- and risk-sharing in public-private partnership (PPP).

In short, the private sector contributes to GDP and government revenue, creates jobs thereby ensures inclusive development, alleviates poverty and improves society's well-being.

3.2 The private sector in successful countries

Japan

Most of the previous studies suggested that the expansionary fiscal policies adopted by the Japanese government in the 1930s were key factor for Japan's economic recovery from the Great Depression. A few focus on the role of the private sector. Recently Lee (2015) reassessed the impact of monetary and fiscal policies on real output from private sector perspective and thereby on takeoff in the 1930s. His research found that both monetary and fiscal policies are inconsistent or do not have an impact on real output, but the private sector, especially private sector consumption, made majority of fluctuations in output. This research also found that the impact of export shock on output is unclear, and the devaluation of Japanese yen has a significant effect on output and price level.



The main conclusion of Lee's study is the Japan's economic recovery in the 1930s was initiated by the private sector and led by pump-priming effects of policy measures. The population growth in the 1920s led to a dramatic increase in urbanization and Japanese lifestyle, change in consumer behavior, mass consumer society began to move in the 1930s. As a result, the increase in private spending on consumer goods, led to an increase in the amount of money in circulation, has been the driving force of the Japan's economic recovery in the 1930s.

South Korea

Korea is a successful country in the region. Most of studies of the Korea's successful economic development showed crucial factors of the success are open and outward-looking strategies. In particular, the success brought by the political leadership, scientific and technological competencies, successful implementation of plans, credit rationing and financial repression. Kim (n.d.) developed a policy-oriented institutional interpretation of the Korea's success which focuses on the private sector's contribution. According to his interpretation in the 1960s the Korean government provided private sector with strong financial incentives; The private sector contributed a large part of the export; The private sector has prepared for heavy industry and chemicals (HCIs) before the government; The rent-seeking culture has been transformed into productive entrepreneurship; The private sector has influenced evolution of development strategies and plans; Heavy-handed industrial and banking policies with limited negative side effects resulted from the transparent and predictable government and the open and market-friendly policies.

3.3. The private economic sector in Vietnam

The private economic sector in Vietnam

Before 1986, the private economic sector had not been officially recognized in Vietnam. However it had been existed to fill the rooms left by the state sector. In 1975 private enterprises and handicraft production accounted for 8.3 percent of the total production in the North (GSO, 1984). In 1986 this sector created 15.3 percent of the manufacturing output and hired 23.2 percent of the labor force (GSO, 2019).

In 1986 the DoiMoi policy had been implemented, the private economic sector had been officially recognized. In 1989, the number of the registered enterprises in the country was 333,300 (Le Huy, 2019). In 2000, the new Law on Enterprises has been in effect, this led to a significant increase in non-state manufacturing output, from 23 percent in 2000 to 26.1 percent in the first half of the year 2003 (GSO, 2003).

In 1990, the Law on Companies (NAV, 1990) and the Law on Private Enterprises (NAV, 1990) were introduced by which private enterprises were formally recognized. Although, the requirements for establishment of enterprises were extremely sophisticated, making enterprise establishment too high cost and time consuming.

In 1999, the Law on Enterprises (NAV, 1999) replaced the Law on Companies and the Law on Private Enterprises, creating favorable environment for the private sector to develop. The procedure for registration of opening enterprise has been simplified, many cumbersome conditions have been removed and the mindset of the state management agencies has positively changed. Under this Law all citizens have a freedom to do business. Private enterprises and ownership have been protected. Thanks for that, the number of registered enterprises has dramatically increased.

In 2004, the Law on Investment (NAV, 2004) and the Law on Enterprises (NAV, 2004) were amended, creating a common legal framework for all investors regardless of their nationality and type of ownership. In 2014 the Law on Investment (NAV, 2014) and the Law on Enterprises (NAV, 2014) were amended again, creating a legal framework for investment and doing business consistent with international practices and meet requirements of the signed trade agreements. Firstly, the freedom for doing business, under the Vietnamese Constitution, has been respected.

Secondly, quality of public services and time limits for getting enterprise establishment permits were also significantly improved. Thirdly, the support services provided by the Planning and Investment Department staff (particularly in Hanoi and Ho Chi Minh City) have also been significantly improved.

In 2016 the Ministry of Justice reviewed the Law on Enterprise 2014 and the Law on Investment 2014 to eliminate inappropriate business conditions. Recently, the Central Institute for Economic and Management Studies recommended removing 3,000 inappropriate business conditions. These changes help private businesses to compete fairly with businesses in other sectors in the economy.

Resolution 35/NQ-CP (CEC, 2016) of the Government makes easier access to finance, operation space and markets for private enterprises and reduction of their production costs.

Resolution 10-NQ/TW 2017 reaffirms the role of the private economic sector in achieving the country's development goals (CEC, 2017) which positively influenced the private sector.

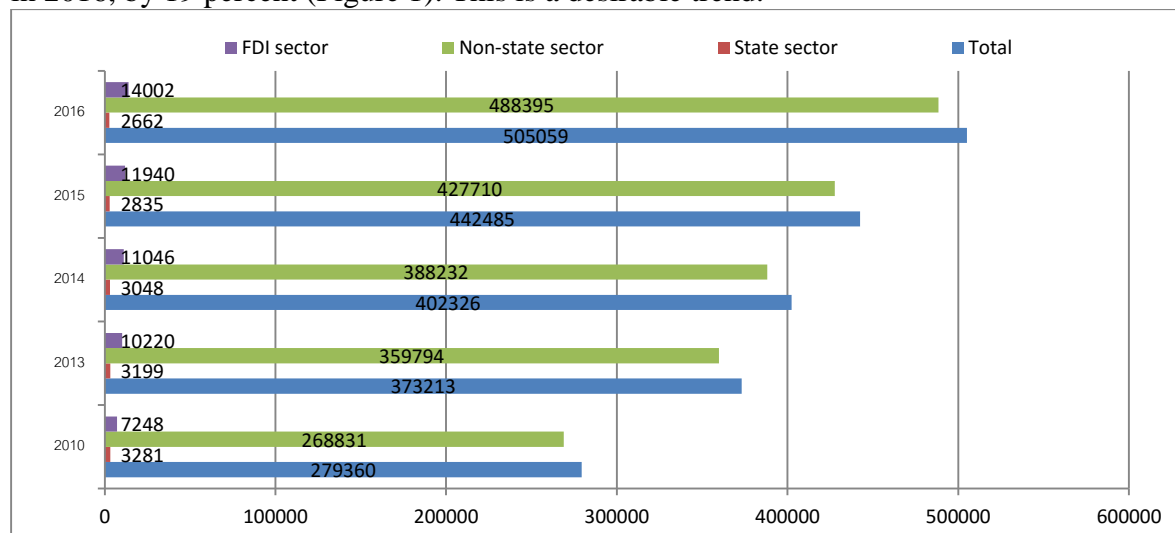
Decree 63/2018/ND-CP (GV, 2018) allows the private sector to act as a partner of the public sector in investment projects.

In 2017, the 5th plenum resolution of the XIIth session reaffirmed the need to develop the private economic sector into a driving force of the economy. This resolution emphasizes the quality and effectiveness of the private sector's activities with the goal of creating a sustainable private sector to contribute 50 percent to GDP by 2020, 55 percent by 2025 and 60-65 percent by 2030.

On May 2th and 3rd 2019 the Private Economic Forum was organized to look for initiatives to develop the private sector. This presents the political will of the government to remove obstacles for the private sector to play its role in achieving the national strategic goals.

Private sector expansion

Thanks for policy adjustments and improvements in the business environment, the number of businesses operating in the private sector in 2010 was 268,831, which increased to 488,395 in 2016, by of 1.8 times while the number of state enterprises decreased from 3,281 in 2010 to 2,662 in 2016, by 19 percent (Figure 1). This is a desirable trend.

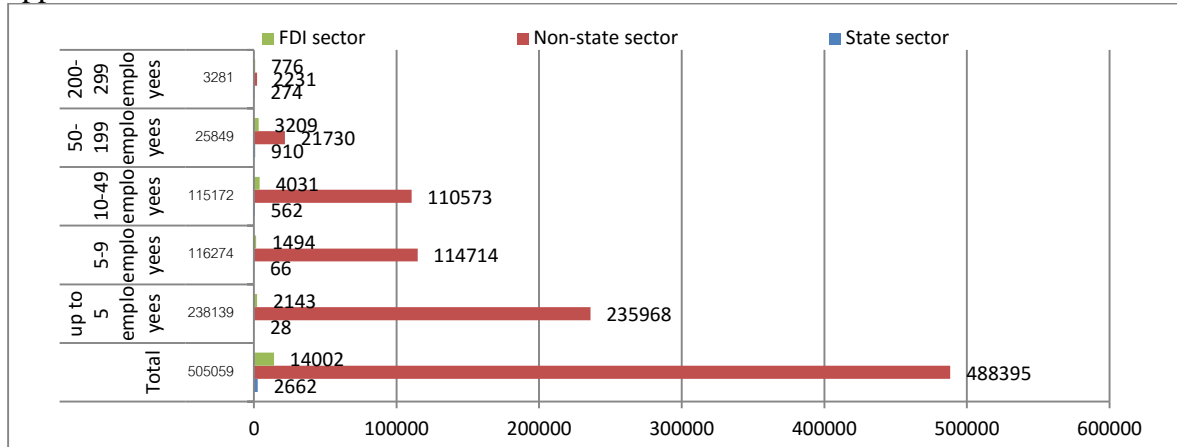


Source: GSO, 2017

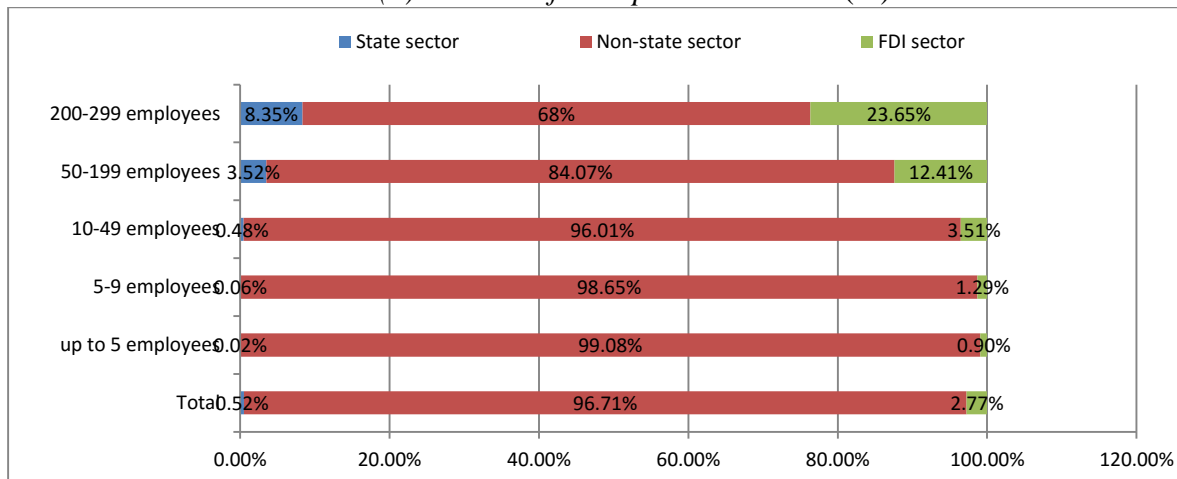
Figure 1. Number of businesses operating in the period 2010-2016

In spite of the increase in quantity, most of enterprises - 96 percent are small and medium, even though, micro enterprises (Figure 2). This is a consequence of the unfavorable institutional

environment, particularly, limited access to finance, new technology and modern management approaches.



(a) Number of enterprises Structure (%)



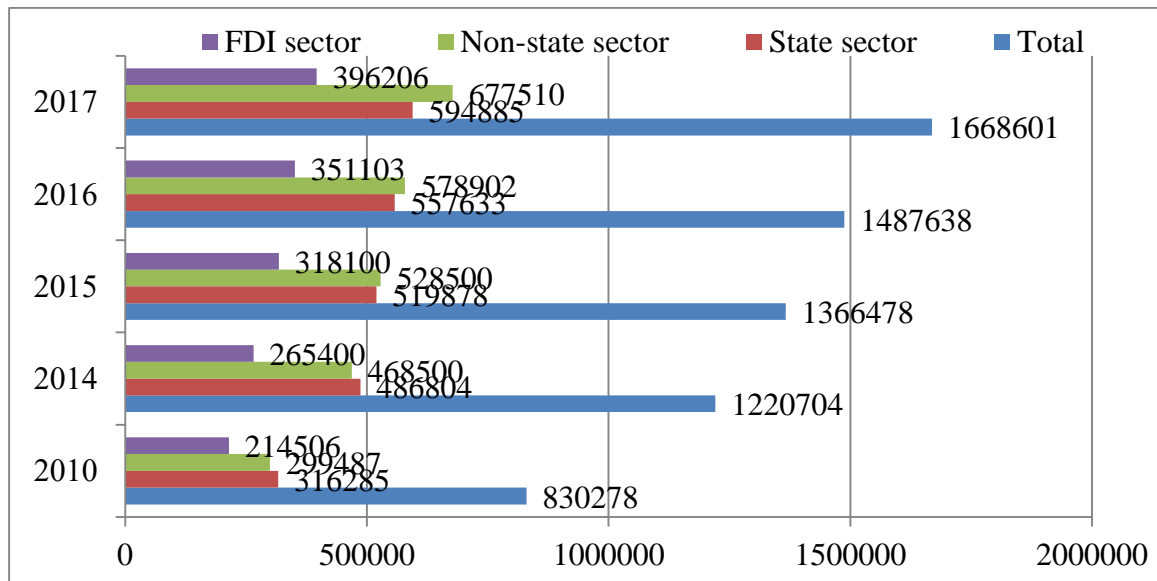
(b) Structure (%)

Source: GSO, 2017

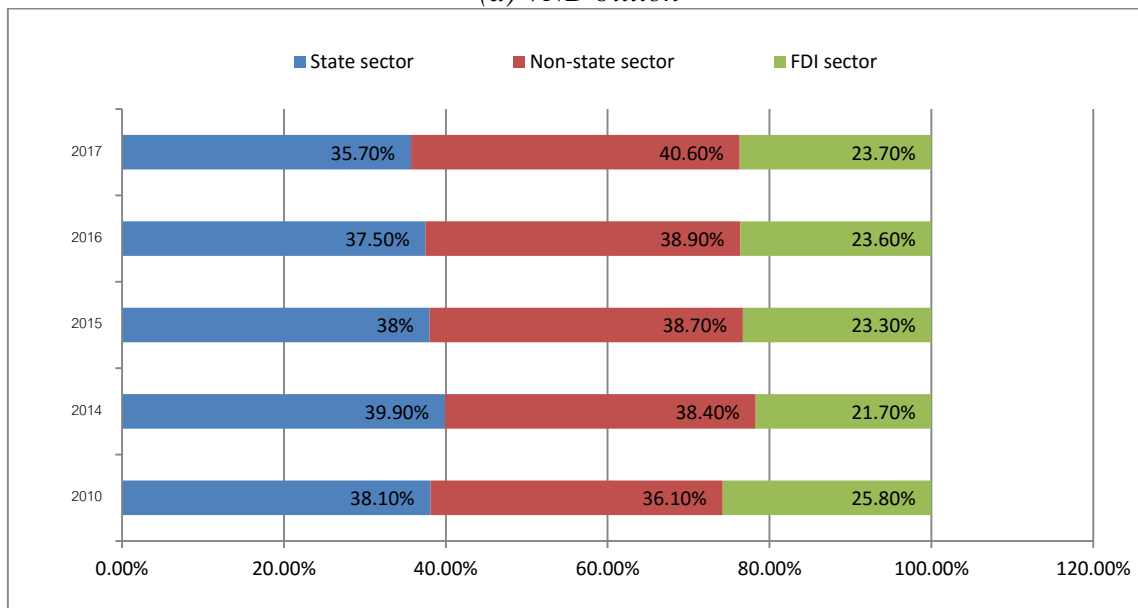
Figure 2. Enterprises operating at 31 December 2016, by size

Contribution of the private sector for investment

The consequence of the increased number of enterprises is the increase in investment in all sectors in the economy. Total investment in 2010 was VND 830,279 billion, compared to VND 1,668,601 billion in 2016. However, there is no clear structural shift. The share of the foreign investment sector (FDI) and the state sector are resembles and both slightly fluctuated in the interval of 36 to 40 percent. The private sector accounted the rest, 22 to 26 percent (Figure 3). It will be better if public sector spend its resources for activities where the market fails rather than engage in supplying goods and services



(a) VND billion



(b) Structure (%)

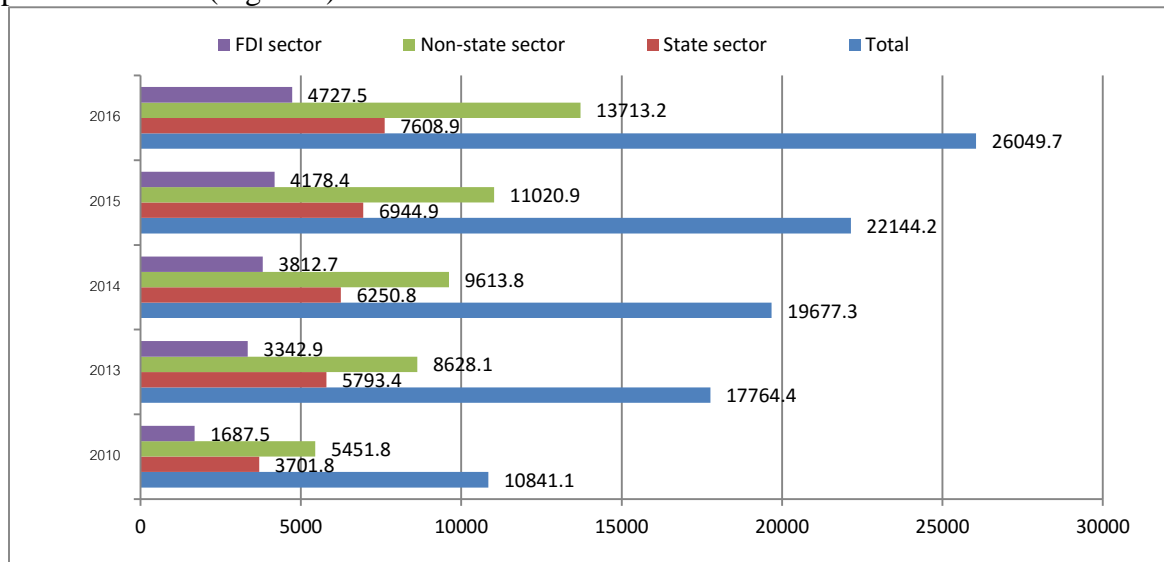
Source: GSO, 2017

Figure 3. The Enterprises' investment

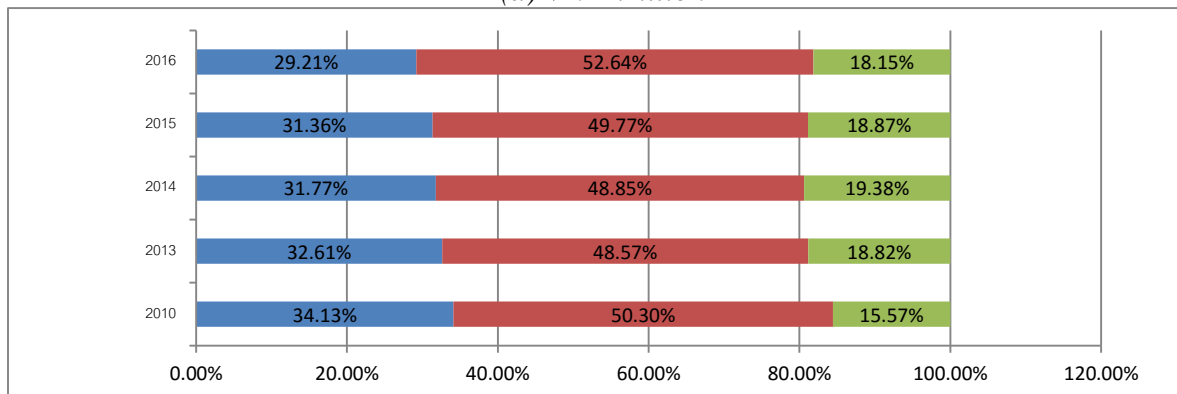
Contribution of the private sector for production capital

In the period of 2010-2016 the economy's production capital increased considerably. In 2010 the total amount of production capital was VND 10,841.1 trillion and in 2016 this number was VND 26,049.7 trillion, increased by 2.4 times. In the private sector, that numbers were VND 5,451.8 trillion and VND 13713.2 trillion, respectively, increased by 2.5 times, and of the FDI sector was VND 1,687.5 trillion and VND 4,727.5 trillion, respectively, increased by 2.8 times. While, that of the state sector were VND 3,701.8 trillion and VND 7,608.9 trillion, respectively, increased approximately 2.1 times. Thus, the private sector's production capital significantly increased, gradually affirming its role of a driving force in economic growth. The structure of the production capital shows the largest share belong to the private sector - 50.3

percent in 2010. Since 2010 to 2014 it fluctuated and reached 52.64 percent in 2015, while the share of the state sector was 34.13 percent in 2010, steadily decreased and reached to 29.21 percent in 2016 (Figure 4).



(a) VND trillion



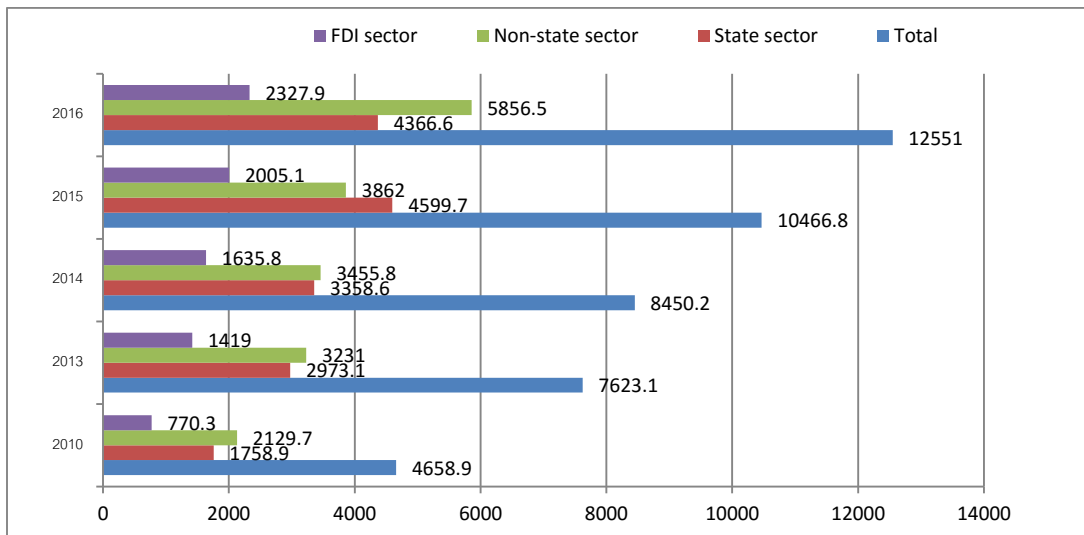
(b) Structure (%)

Source: GSO, 2017

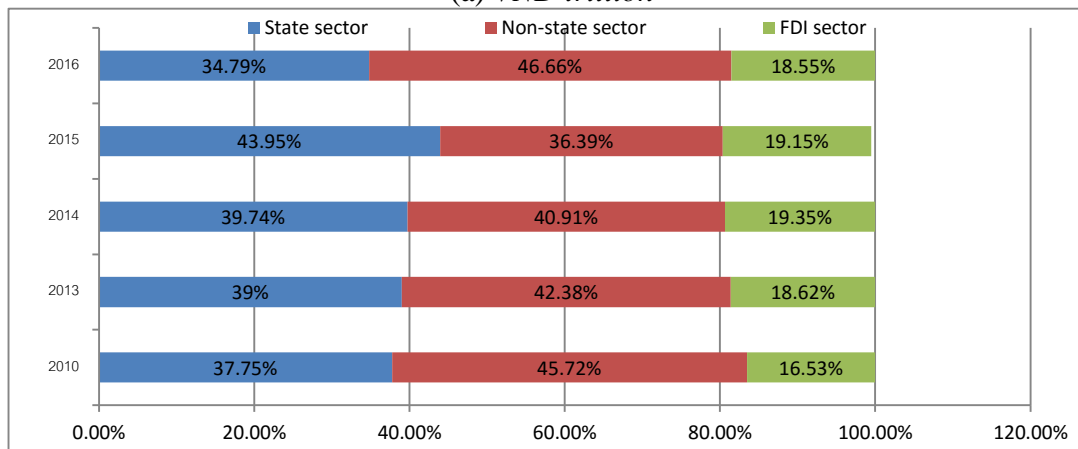
Figure 4. Production capital of enterprises

Contribution of the private sector for assets and long term financial investments

The amount of the fixed assets and long term financial investments of the economy in the period of 2010 -2016 significantly increased. In 2010 the total amount of the fixed assets and long term financial investment was VND 4,658.9 trillion, in 2016 it was VND 12,551 trillion, increased by 2.69 times. Those figures of the private sector were VND 2,129.7 trillion and VND 5,856.5 trillion, respectively, increased by 2.74 times, while the state sector's amount was VND 1,758.9 trillion in 2010 and VND 4,366.6 trillion in 2016, grown up by 2.48 times. The state sector's share tends to decrease while the share of the private sector shows a tendency of increase. In 2016 the private sector accounted for 52.64 percent while the state sector accounted for 29.21 percent only (Figure 5).



(a) VND trillion



(b) Structure (%)

Source: GSO, 2017

Figure 5. The fixed assets and long term financial investments

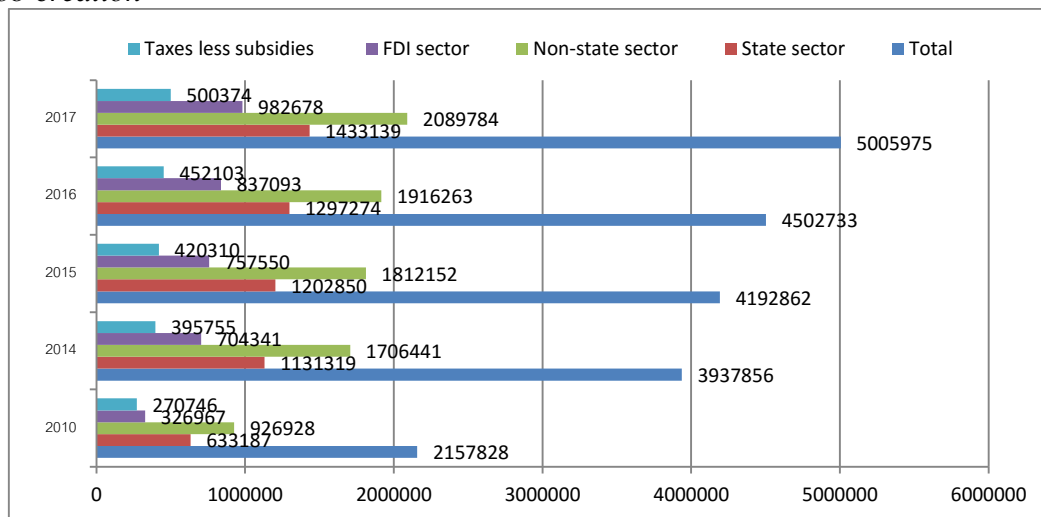
Contribution of the private sector for country prosperity

In the period of 2010 - 2017 there was an increase in the number of enterprises and investments, fixed assets and long term financial investments. All this makes the GDP in 2017 (VND 5,005,975 billion) is equal to 2.32 times of that in 2010 (VND 2,157,828 billion). The private sector, a largest contributor, created VND 2,089,784 billion in 2017, it equal to 2.25 times of that in 2010 (VND 926,928 billion). At the second place is the state sector which contributed VND 1,433,139 billion, increased 2.26 times in comparison with that in 2010. Two sectors have parallelly grew up.

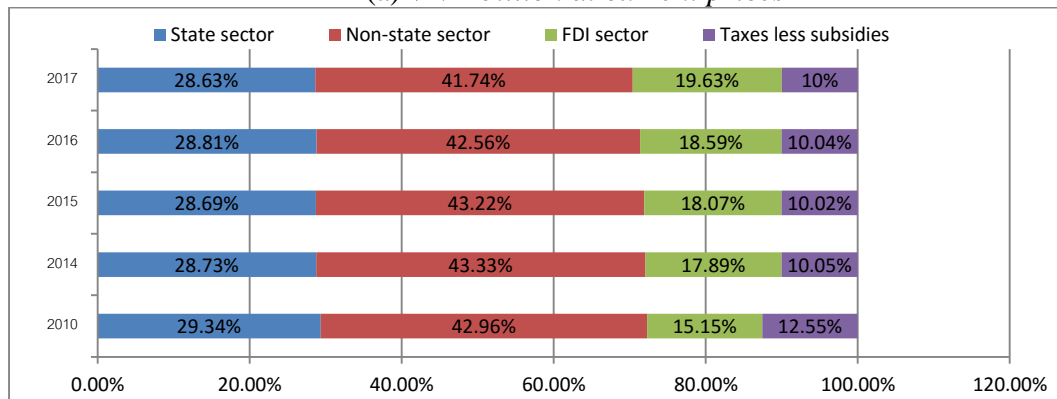
The slow structural shift is observed. The share of the state sector tends to decrease and the share of the private and foreign investment ones tend to increase. The private sector accounted for approximate 43 percent in this period. The state sector accounted 29.34 percent in 2010 and 28.63 percent in 2017. Within eight years the share of the state sector decreased by 0.71%. The foreign investment sector expanded most, after 8 years its share increased by 4.48 percent, from 15.15 percent in 2010 to 19.63 percent in 2017. Its increase is at expense of the state sector and net tax revenue. Unfortunately, the private sector "did not grown up". This is because there obstacles in the institutional environment, especially in the enforcement characteristics (Figure 6).

In 2010, the growth rate of the private sector was 4.73 percent and that of the state sector was 4.76 percent. But in the following years, the private sector has grown at higher rate than the state one. The largest gap between the growth rates of the private sector and the state one occurred in 2017 (6.23 percent compared to 4.22 percent). It can be said that the state sector is losing its advantages to the private sector. The picture is clearer if you compare private enterprises (i.e. private enterprises operating the formal sector) with state-owned ones. In 2010 private enterprises grew by 6.05 percent - in 2014 and this figure was 6.75 percent, in 2015 it was 8.21 percent, in 2016 and 2017 the the growth rate of private enterprises is 11.41 percent and 11.72 percent, respectively (Figure 7).

Job creation



(a) VND billion at current prices

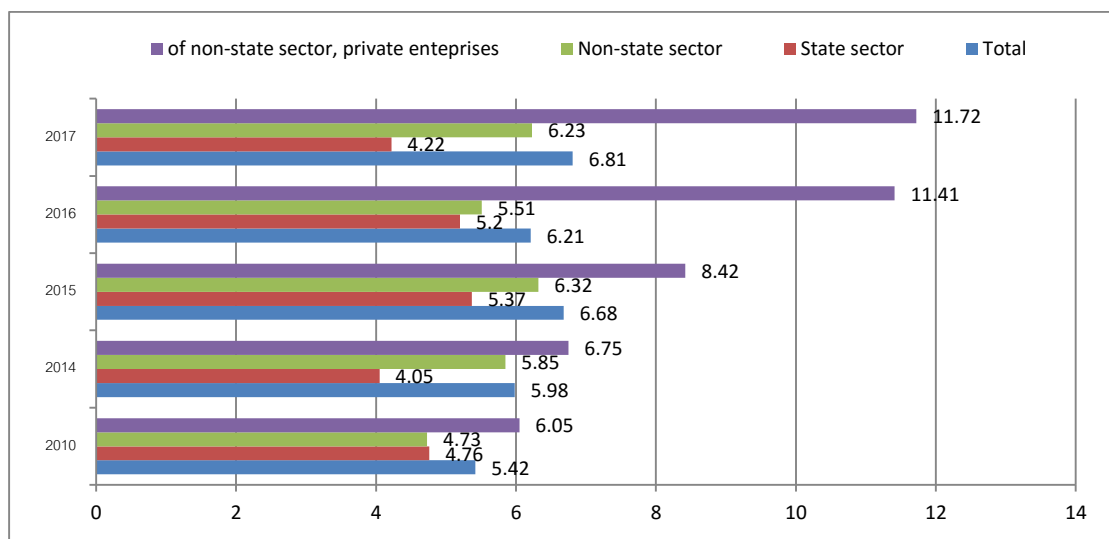


(b) Structure (%)

Source: GSO, 2017

Figure 6. GDP by sector by type of ownership

The private sector plays an increasing role in job creation in the economy. 3.35 million new jobs were created by the FDI sector and private enterprises in the period of 2010 - 2015, or 557,000 per annum on average, of which 288,000 created by the private enterprises (Le Huy, 2019). Family businesses were not included in this number. Obviously, the public sector cannot provide new jobs so much for new entrants in the labor market. Job creation is the way to ensure growth and handle social problems accompanied with unemployment. By finding job the poors have a chance to alleviate their poverty and thank for that their children will have access to education and healthcare. Undoubtedly, the private sector contributes for sustainable development.



Source: GSO, 2017

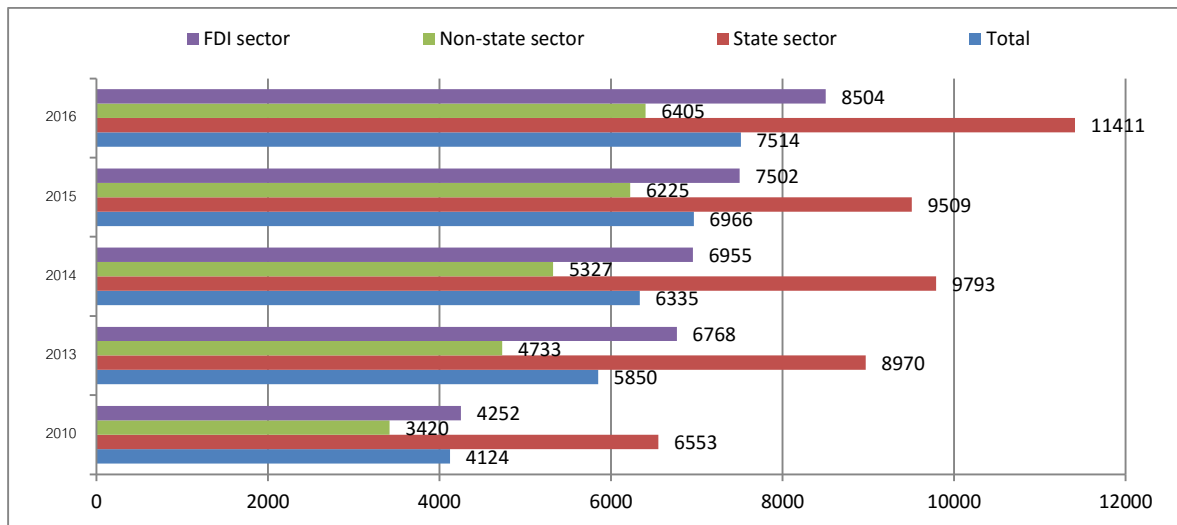
Figure 7. Growth rate of GDP at constant prices 2010, by sectors (percent)

Income of employees in enterprises

Along with the development of the economy, the income of employees has been improved markedly. The average monthly income of employee in 2016 increased by 1.8 times compared to that in 2010, VND7,514 thousand (equivalent USD342) compared to VND4,124 thousand (equivalent USD196). Take a closer look at sectors, in the private sector the monthly income of employees in 2016 increased by 1.87 times compared to that in 2010 (VND6,405 thousand - equivalent USD291 - compared to VND3,420 thousand - equivalent USD163). In the state sector, the monthly income of employees in 2016 increased by 1.74 times compared to that in 2010 - VND11,411 thousand (equivalent USD518) compared to VND6,553 thousand (equivalent USD312). The employee's monthly income in the FDI sector in 2016 is double of that in 2010 - VND8,504 thousand (equivalent USD387) compared to VND4,252 thousand (equivalent USD202) (Figure 8).

The increased income brings employees a better life, with higher income they can buy more foods, have an access to healthcare, education and training, thereby their productivity will increase, and in turn, that will have a positive effect on their income.

The private sector, in spite of the fact that it has a disadvantageous position, brought employees income growing at higher rate than the state one.

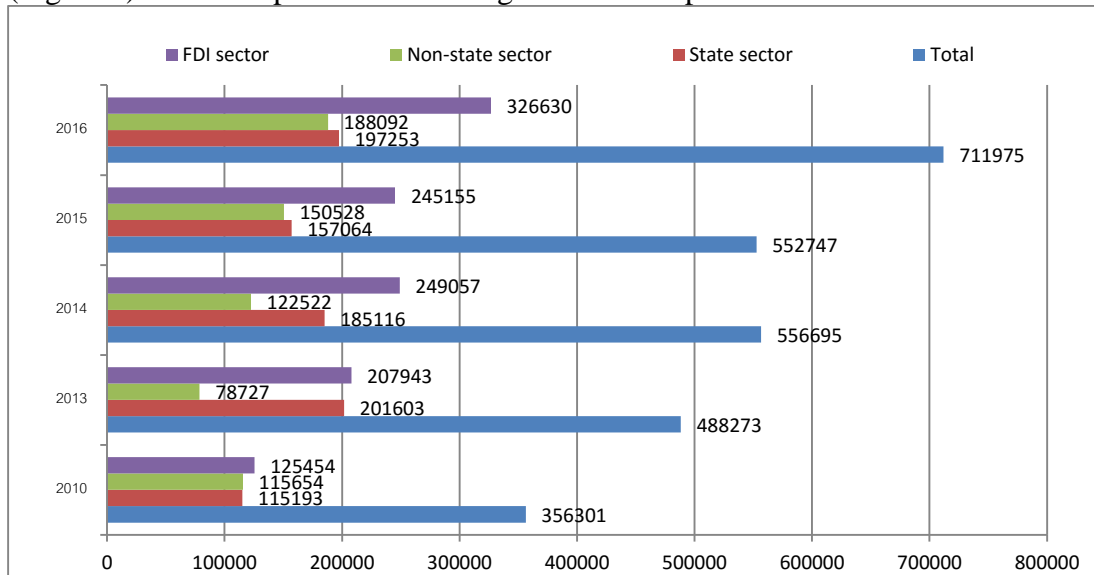


Source: GSO, 2017

Figure 8. The monthly income of employees in enterprises (VND thousand)

Government revenue

The Vietnamese government revenue has been increased. In 2010 total government revenue was VND588.428 billion, in 2017 it is VND1,288,665 billion, increased 2.19 times. The state sector's contribution increased by 2.74 times - VND377.030 billion in 2010 raised to VND1,032,164 billion in 2017. In contrast, the contribution of the private sector in 2017 was equal to 1.31 times of that in 2010 - VND147,235 billion in 2017, compared to VND112,143 billion in 2010. This is because a large number of private enterprises operating in the informal sector to avoid taxes. In addition, the sophisticated administrative procedures and lack of transparency in implementation discouraged entrepreneurs to shift into the formal sector. The dramatic increase in the contribution of the private enterprises operating in the formal sector was evident in the period of 2010-2016 - VND70,023 billion in 2010 increased to VND181,005 billion in 2017, by 2.58 times (Figure 9). This fact presents the strong shift of enterprises from the informal into the formal one.



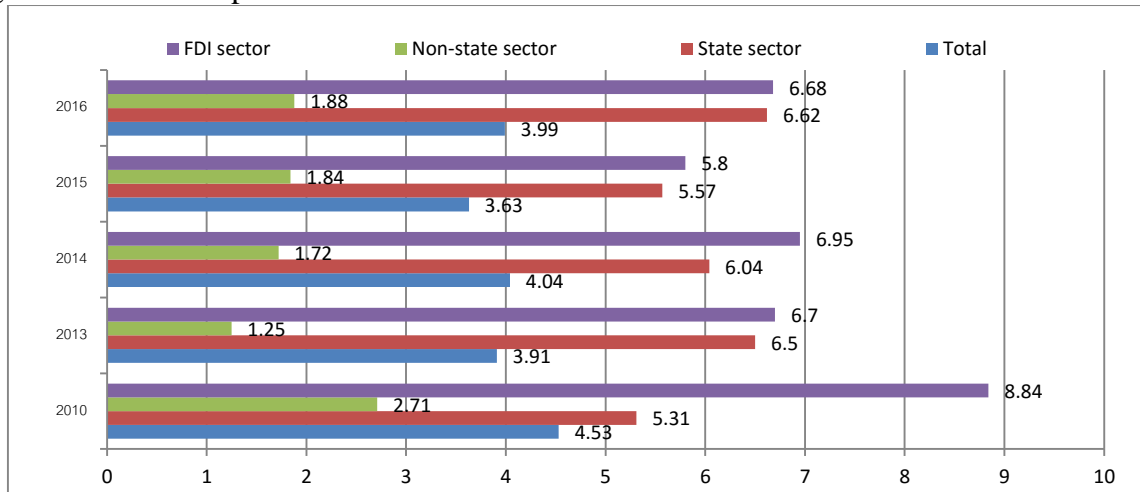
Source: GSO, 2017

Figure 9. Government revenue

Enterprises' performance

Despite the investment efforts and expansion of the private sector, its performance has not been improved. In 2010 the profit margin of the private enterprises was 2.71 percent, but in 2013 it dropped to 1.25 percent; in 2014, 2015, and 2016 those numbers were 1.72 percent, 1.84 percent and 1.88 percent, respectively (Figure 10). This resulted from unfavorable business environment.

The SMEs are disadvantageous in raising productivity and technology innovation. The question is why enterprises did not grow up as years passed? The answer can be found in the enforcement practices - the larger the enterprise's size, the more times of being inspected which accompanied with harassment from those performing administrative tasks. As a consequence, the large number of enterprises remains in the informal sector to avoid informal costs.



Source: GSO, 2017

Figure 10. Profit margin of enterprises (%)

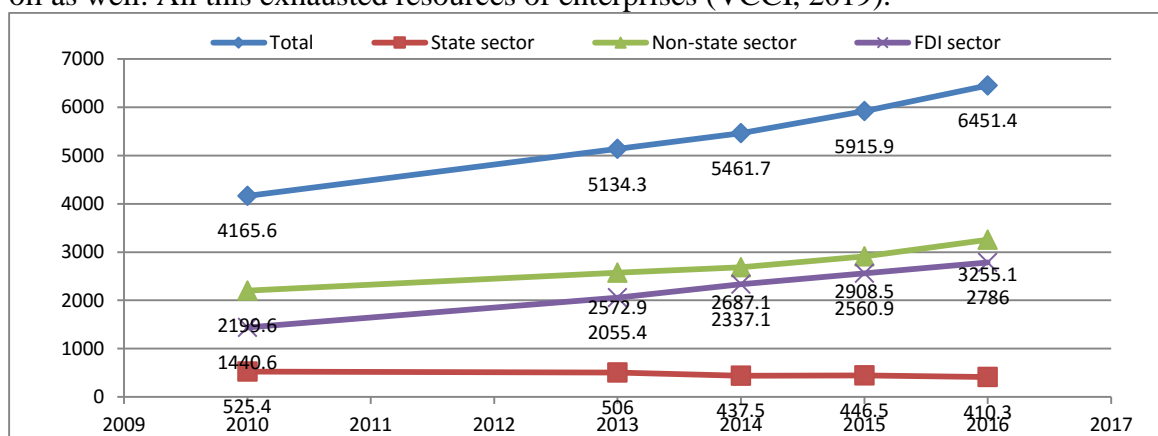
Contribution for gender equality

Women participation in the workforce is a social progress. In the period of 2010 - 2016 the number of female workers in the economy increased significantly. In 2010 there were 4,165.6 thousand women working in enterprises, in 2016 the number was 6,451.4 thousand. However, in the state sector there is a decrease in absolute and relative value: in 2010 - 525.4 thousand, decreased by 12.62 percent, in 2016 - 410.3 thousand, dropped by 6.36 percent. In contrast, the number of female employees in the private sector has steadily increased both absolutely and relatively. In 2010 this number was 2,199.6 thousand accounted for 52.8 percent, in 2016 it is 3255.1 thousand, accounted 50.45 percent (Figure 11). The private sector plays a crucial role in ensuring gender equality.

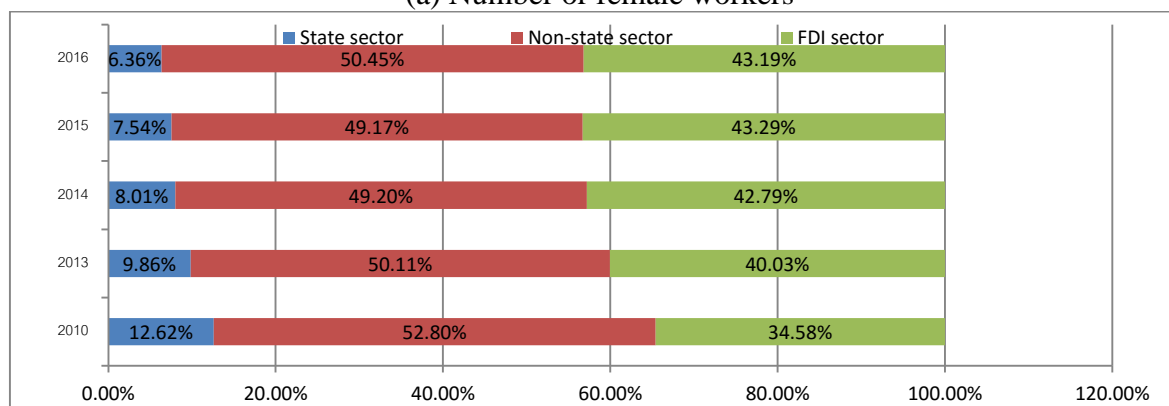
It is known that operating enterprises determine economy's healthy. This is because they are driving force of economic growth. However, one of the biggest challenges of Vietnam economy is the fact that majority of enterprises are SMEs, operating in the private sector. The SMEs operate in disadvantageous institutional environment. Obstacles hindering development off SMEs are limited access to finance, high labor costs, low level of technology, tight competition and high costs of complying formal rules; At the organizational level, factors hindering private enterprises' development are low flexibility of SMEs to shift from the informal into the formal one, the firm's low competence and poor organizational strategic orientation (Cao Thuy, 2018).

Sophisticated administrative procedures and unprofessionalism of the administrative officials and pervasive corruption are the main factors leading to high costs of obeying them. Take an example, the costs of preparation of a profile for construction permit and informal consultancy accounts for 67 percent of costs for administrative procedures (this number is the national average

and it varies from region to region). In the field of customs, in 2017 53 percent of surveyed enterprises responded that they paid informal costs, compared to 56.4 percent in 2016 - a minor improvement. In the period of 2014-2016 0 - 11 percent of respondents revealed that these costs accounted for more than 10 percent of their total costs of doing business. In the previous 5 years this number was 6-8 percent only. Furthermore, the social environment also is not so safe - 3 percent of surveyed enterprises revealed that they paid individuals or groups (black society) for being safe. On the other side, the logistics costs are unacceptable high. For example, the cost of shipping a container over 100 km, from Hai Phong port to Hanoi is three times of that of shipping a container from China or Korea to Vietnam. There are additional shipping charges for petrol and oil as well. All this exhausted resources of enterprises (VCCI, 2019).



(a) Number of female workers



(b) Structure (%)

Source: GSO, 2017

Figure 11. Female employees in enterprises

4. Conclusion and policy implications

The changing mindset of the government on the role of the private sector in the nation's economic development has led to policy adjustments which facilitate the development of the private sector: simplifying administrative procedures; easier access to land, finance and infrastructure; removing discrimination between public and private sector; enhancing transparency in government administration. Consequently, the private sector grown up, its contribution to society's prosperity and sustainable development has raised more and more. Nevertheless, the institutional environment still contains obstacles that need to be removed to ensure the private sector becoming one of the driving forces of the economy.



Basing on implications of the Japanese and Korean cases, we have to bear in mind that to achieve strategic goals the government have to maintain transparency and predictability and adopt open and market-friendly policies. The emphasis must be put on the private sector development and entrepreneurship. To do so, it is necessary that the government provides the private sector right incentives and supports in right time. In the case of Vietnam, the following suggestions are proposed. *Firstly*, in a further reform of institutional environment the focus must be put on the improvement of enforcement characteristics. This is because there are differences between *de jure* institutional improvements and *de facto* ones. Laws have been amended and decrees have been introduced, but specific programs, supports and goals were absent. Thus, it is necessary to create a competent staff for fulfilling public services and control corruption. *Secondly*, supports from the government side are needed to improve organizational factors of the institutional environment. In Vietnam, the majority of private enterprises are SMEs, therefore it is difficult for them to exploit economies of scale. They are not willing to expand their capacity due to disadvantages of being inspected inappropriately which means increased informal costs. In addition, the private enterprises mainly provide goods and services to domestic markets where the competition is tight, so they need supports from industrial management agencies to open new markets abroad. The government should provide incentives for innovation activities and support competence upgrading for entrepreneurs.

Limitations

For a long time, the private sector in Vietnam has not been officially recognized. However family businesses have never disappeared. It is an important part of the private sector, because they play the crucial role for sustainable development. In Vietnam there are 5.1 million family businesses. Because of their large quantity importance family businesses deserve to be studied in another project.

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