



**DANANG: KEY REGULATORY PROBLEMS  
CONSTRAINING LOCAL BUSINESS  
COMPETITIVENESS**

**VNCI staff and consultants prepared this report**



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## I. INTRODUCTION

### **Report objective**

The objective of this report is to identify, analyze and provide policy recommendations on selected key factors constraining business competitiveness in Danang. The aim is to provide lessons that can be used to further improve the business environment for local enterprises in Danang.

The report focuses on small and medium-sized enterprises (SMEs) as the private business development has become an integral element of both provincial and national level economic development.

The findings in this report have been drawn from the research on Danang, hence, one should be cautious not to automatically generalize them as national problems. However, the authors of this report expect that the lessons of Danang can be useful for the local governments of other cities and provinces in the country in developing a business enabling environment in their localities, as well as for the central government in developing policies and regulations that promote business activities across the country.

### **Methodology**

The research described below has been carried out as part of the provincial-level programs under the first component of the Vietnam Competitiveness Initiative (VNCI). The VNCI is a joint project of the United States Agency for International Development (USAID) and the Government of Vietnam, and is managed by Development Alternatives Inc. (DAI). The Asia Foundation is the principal subcontractor to DAI and is responsible for implementing Component One of the project on “creating a favorable regulatory environment for business”.

In Danang, the primary background research was conducted by the Center for Management and Corporate Consultancy (CMCC) of the University of Danang, with the support from the Danang Branch of the Vietnam Chamber of Commerce and Industry (VCCI) and from VNCI. VNCI staff and consultants carried out more detailed research activities.

The research was carried out in a multi-staged manner as below.

*Stage 1 – Issue identification:* Factors affecting the business environment and the competitiveness of the private sector were first identified through the survey of 50 local small private businesses using both structured questions and broad discussion points. The survey was undertaken by a working group of experts from the SME Promotion Center of VCCI Danang, Department of Planning and Investment of Danang, economic reporters from *Business Forum* and *Saigon Times Daily*, and CMCC researchers.

*Stage 2 – Roundtable discussion:* The working group then met in a roundtable discussion to discuss and select key issues that would be the focus of further in-depth analysis.

*Stage 3 – Research and analysis:* Using material drawn from the survey and the round table discussion, various desk studies and other sources, researchers from the CMCC analyzed the selected identified factors constraining business competitiveness in Danang and proposed policy remedies.

*Finally,* the results were disseminated by the CMCC in a public-private dialogue (PPD). The PPD was essentially a forum where both the business community and local government met to discuss the various options for remedying identified regulatory constraints to local business environment.

The survey of 50 firms was conducted from 15-22 May 2004. The PPD was organized in Danang on 23 September 2004 with the participation of senior officials from Danang's Department of Planning and Investment, Tax and Customs.

## **Report structure**

The research paper comprises a brief overview of recent economic developments in Danang and a discussion of the survey results. This is followed by a detailed description and analysis of selected findings of the research on selected constraints to local business competitiveness. Where necessary, important information drawn from firm-level interviews have been developed into case studies to highlight the issues. Policy remedies to the analyzed problems are then proposed at the end of each section.

The following constraints are addressed in this report:

- Access to finance;
- Access to land;
- Tax policy and administration;
- Regulatory decision-making process.

Impact analysis of costs and benefits of recommendations are discussed on a qualitative basis since the quantification would require a greater amount of time, expertise and other resources, which is not feasible in this assignment. Further analysis would be required to make such quantifiable conclusions.

## **Acknowledgements**

We would like to express our sincere thanks to:

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- Mr. Nguyen Duc Xa, Head of the Business Registration, Department of Planning and Investment, Danang; Mr. Luu Duc Sau, Head of the Tax Collection Support of the Tax Department, Danang; Mrs. Pham Chi Lan, Consultant from the Prime Minister's Research Commission; Mr. Nguyen Dinh Cung, Team Leader of the Government Working Group on the implementation of the Enterprise Law; and many of the experts, journalists, and representatives of enterprises and banks for their participation and constructive comments in the PPD event and on the content of this report.

## **II. DANANG: PRIVATE SECTOR DEVELOPMENT**

### **Recent economic developments**

With a population of about 730,000, Danang is the fourth largest city in Vietnam and the largest in the central part of the country. For the latter, it is generally known as “the center of the center”. The city also has the geographic advantage of being in a strategic position on the north-south traffic routes for road, rail, air, and sea traffic (Xuan Thanh, 2003). In spite of these strategic advantages, Danang did not officially become a major city until 1997, following a decision by the National Assembly on 6 November 1996.

The conferring of major city status means Danang can receive more investment from the state for infrastructure and for administrative upgrading. Therefore, Danang has been considered a big infrastructure spender for the past few years, with the building of the Song Han Bridge, expanded and upgraded seaport, airport and road system, and the establishment of five industrial zones, Hoa Khanh, An Don (also known as Danang), Hoa Cam, Lien Chieu and Tho Quang. However, the city has not been regarded as an impressive business facilitator (Dapice, 2003; Xuan Thanh, 2003).

During the past four years there has been very rapid growth in the private sector. Nevertheless, Danang continues to be a major infrastructure development center and the share of SOEs in total output and provincial GDP remains high, suggesting that the state sector is growing even at a higher rate than the private sector.

**Table 1: GDP in Danang, by ownership 2002-2003**

*Percentage of total provincial GDP*

<b>Year</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>
State-owned enterprises (SOEs)	54.9	55.4	56.6	57.4
<i>Of which are national SOEs</i>	36.5	38.4	38.8	39.9
Private firms	31.9	31.3	31.1	30.4
Foreign-invested enterprises (FIEs)	8	8.2	7.3	7.3
Private companies	8.4	9.3	6.8	7.9
Others	5.3	5.1	5	4.9

*Source: Danang DSO, 2003*

*Table 1* above shows that the share of SOEs in total GDP increased from 54.9 percent in 2000 to 57.4 percent in 2003, while the share of the private sector even reduced slightly from 31.9 percent to 30.4 percent, respectively (Danang DSO, 2003). It is interesting to note that the share of local SOEs also reduced at a similar rate and so does the foreign-invested enterprise (FIE) sector during the same period. The central SOEs, in fact contributed to more than half of all growth in GDP in Danang in 2001, and about 46 percent of growth in 2003. That should not be a surprise, given the fact that the state investment from both the local and the central government remains a dominant factor, accounting for around 86 percent of total investment (*Table 2*).

**Table 2: Investment in Danang 2000-2003, by ownership**

<b>Year</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>
Total (VNDBillion)	2,359.1	2,527.6	2,850.1	3,267.5
State (percent)	82.9	83.6	87.5	85.7
<i>Of which:</i>				
<i>Central</i>	31.3	35.9	40.4	35.6
<i>Local</i>	51.6	47.7	47.1	50.2
Private (percent)	8.4	9.3	6.8	7.9
FDI (percent)	8.6	7.1	5.7	6.4

*Source: Danang DSO, 2004*

At the same time, Danang has emerged as one of the provinces where strong private sector development, measured by the number of newly registered enterprises or total registered capital per person, has been recorded since the enactment of the Enterprise Law in 2000. The city ranked sixth of Vietnam's then 61 provinces and province-level cities in terms of total accumulated registered capital per person of newly registered enterprises during that period. *Table 3* shows a very impressive private sector development in Danang in 2001 and especially in 2003, which is far above the national average level. The average value of registered capital per 1,000 persons was around VND2 billion, five times higher than the national average.

**Table 3: Number of newly established enterprises and registered capital per capita 2000-2003**

Year	Vietnam	Danang	Top Five	Top Ten	Bottom Five	Bottom Ten
<b>Registered capital (VND'000/person)</b>						
2000	179	171.2	792.1	623.2	35.7	36.8
2001	328	925.4	1,409.6	1,135.9	35.8	51.9
2002	483	145.4	2,217.7	1,733.2	28.7	60.7
2003	414	2,148	2,849.7	2,414.1	139.7	139.9
<b>Number of newly registered enterprises/ one million inhabitants</b>						
2000	186	219	751	585	44	56
2001	251	685	986	786	50	63
2002	270	169	1,107	862	26	56
2003	363	903	1,363	1,096	82	92

Source: CIEM and UNDP, 2003 and author's calculation

*Note:* Top five provinces in terms of registered capital of newly-established enterprises in four years 2000-2003 per person comprise Ha Noi, Ho Chi Minh City, Binh Duong, Quang Ninh and Hai Phong; Top ten provinces comprise those in the top five plus Danang, Ba Ria-Vung Tau, Bac Ninh, Hung Yen and Phu Yen. Bottom five provinces comprise Thanh Hoa, Nam Dinh, Quang Binh, Son La and Lai Chau; Bottom ten comprise those in bottom five plus Dac Lac, Tra Vinh, Ninh Thuan, Dong Thap and Hoa Binh.

This recent development in Danang poses a very interesting question: How can these two seemingly controversial trends (dominating state-led investment and private sector expansion) coexist? Is this a “miracle” and is it real? What are major reasons behind this seemingly impressive private development in a city where pessimism about the future of private sector development was prevailing just recently? Can the private sector develop further, better and in a more sustainable manner? What are remaining regulatory constraints that prevent the private sector in Danang from further expanding and flourishing?

### **Local policies on private sector development**

It is fair to assert that the local government efforts in promoting and supporting the private sector development plays a certain role in this rapid growth of the sector.

First of all, direct measures have been taken that benefit the private sector in terms of investment concessions and special treatment. The number of investment concessions awarded to the private sector in Danang increased by more than 200 percent between 2000 and 2002, while the value of investments receiving concessions increased by 471 percent (CIEM and UNDP, 2003).

Secondly, simplifying administrative procedures in taxation, custom and land management help reduce significantly costs of start-up and doing business.

Finally, infrastructure improvement may also be a factor, although there are concerns regarding possible crowding-out effects associated with the local government drive for infrastructure building (see next sections for details).

## **Box 1: Key points in Decision 51 – Supporting the private sector development**

### **1. Simplifying procedures for investment application, business registration and application for investment incentives**

- All procedures related to investment policy, planning, land clearances, land lease and land-use rights contracts will be operated on a “one-stop” basis by Centre for Investment Promotion
- Procedures for business registration and obtaining certificates for investment promotion rewards/incentives will be carried out on a “one-stop” basis by the Department of Planning and Investment. Time for business registration should not exceed five working days; and for investment promotion incentives should not exceed 10 working days
- All fees related to investment procedures are exempted, except for standard business registration fee

### **2. Land for business**

- The local government covers 100 percent of land clearance costs for those in the investment priority list or with registered capital of more than VND30 billion or for those who pay for land-use rights. Investors must advance 50 percent of the costs and the city will reimburse it after the project starts its operation. For the rest, the city will cover only 50 percent.

### **3. Land-use fees exemptions**

- All new investment in Danang will be exempted from land-use fee during its construction stage.
- From 2 to 11 years depending on different locations for certain types of investments ( for example those in the priority list or with registered capital of more than VND30 billion)

### **4. Corporate Income Tax (CIT)**

- Different incentive schedules are applied to certain types of investments (mostly for those in the priority list or with registered capital of more than VND30 billion) and locations. For example, applying a 20 percent CIT instead of the standard 28 percent for a period of 10 years; total exemption for 2 years and 50 percent for another three to seven subsequent years.
- Reward for CIT increase: 50 percent of increase in CIT on the year-to-year basic will be rewarded to the firm for investment.

*Source:* Decision 51, Danang People’s Committee, on promoting private sector development, 10 March 2004

Despite such progress, there are concerns and evidence that in the new environment, SMEs face new constraints that may prevent them from operating effectively. The reality, as experienced by the local private business community, is that they still experience a number of problems in obtaining bank loans, accessing land in the industrial zones, obtaining timely information and support on tax policies and participating in the policymaking process. Certainly, some problems are more serious than others. For example, many investors are very concerned about the difficult access to land while appreciating recent improvements in tax and customs procedures. The following sections will highlight these constraints.

Having said that, efforts are under way by the government in Vietnam, at both local and central levels, to further streamline and deregulate rules and regulations and to design development policies towards a more favorable business environment, especially an enabling environment for private sector development. With that in mind, this report can hopefully provide some useful input for their policy consideration.

### III. SURVEY RESULTS

The following table summarizes the results of the survey with 50 local small enterprises on the types of constraints and their levels of importance. Eleven indicators were identified and surveyed firms were asked to rank them by significance of impact on their business competitiveness as "no constraint", "minor", "moderate", "serious", or "very serious".

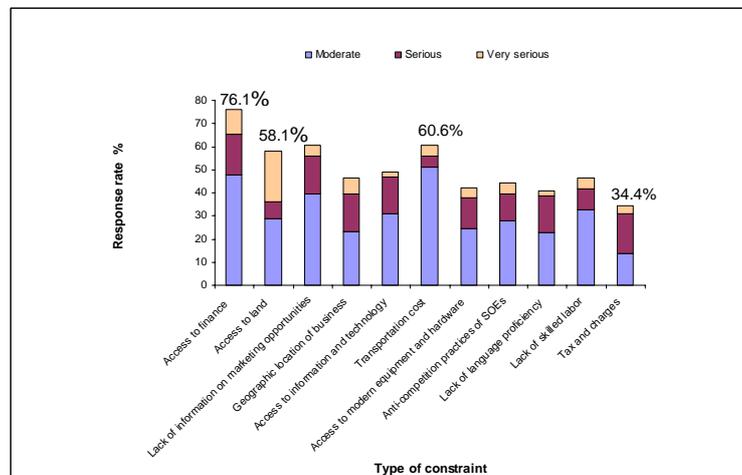
**Table 4: Survey results**

Indicator	Level of constraint		
	Moderate	Serious	Very serious
1. Access to finance	47.8	17.4	10.9
2. Access to land	28.8	7.3	22.0
3. Lack of information on marketing opportunities	39.5	16.3	4.7
4. Geographic location of business	23.3	16.3	7.0
5. Access to information and technology	31.1	15.6	2.2
6. Transportation cost	51.2	4.7	4.7
7. Access to modern equipment and hardware	24.4	13.3	4.4
8. Anti-competition practices of SOEs	27.9	11.6	4.7
9. Lack of language proficiency	22.7	15.9	2.3
10. Lack of skilled labor	32.6	9.3	4.7
11. Tax and charges	13.8	17.2	3.4

The figures in the table represent the percentage of those who were asked and responded that the indicator is a moderate, serious, or very serious constraint. For example, 47.8 percent of the respondents considered access to finance a moderate constraint while 10.9 percent found it a very serious constraint.

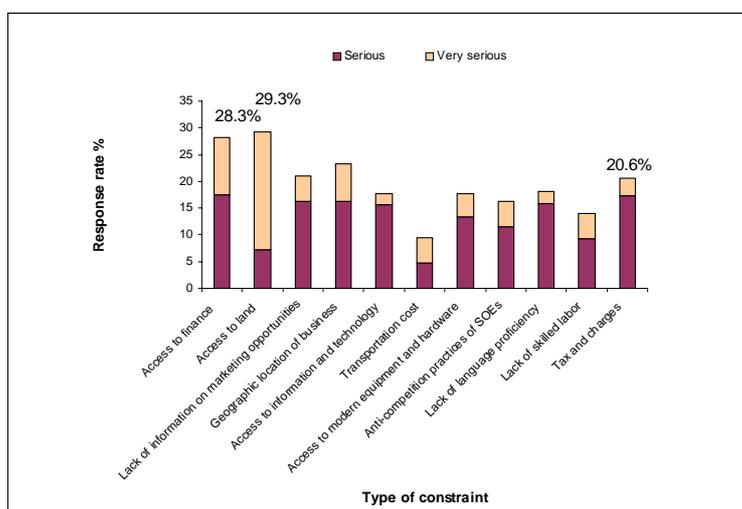
Figure 1 below illustrates the cumulative results of the responses for each type of constraint. Reading from the chart, we see that 76.1 percent of the respondents reported that access to finance is a constraint, 60.6 percent - transportation costs, 58.1 percent - access to land and 34.4 percent - tax and charges.

**Figure 1: Survey Results on Level of Constraints**



The next graph (*Figure 2*) shows the percentage of respondents reporting that the constraint is **significantly** affecting their business performance. It seems however that even though the constraints exist, their impact is not extremely serious. For example, only 29.3 percent of respondents ranked access to land as a factor seriously restricting their competitiveness. This suggests that the local government has made discernible progress in improving the business environment

**Figure 2: Survey Results: The Constraint is Serious**



Three of the indicators found in the above graphs were selected for more in-depth analysis: (i) access to finance, (ii) access to land and (iii) tax policy and administration.

It should be noted, however, that the sample size of 50 firms is relatively small, given that about 3,500 firms operate in Danang. Thus, one should be cautious not to extrapolate the results as a general reflection of the business environment in Danang.

In spite of such a limitation of scope, we believe that the sample and accompanying analysis is useful in picturing part of the business environment of Danang as experienced by the local firms. It is insightful and reflects legitimate desires of the local businesses for a better and more competitive business environment.

## IV. ACCESS TO FINANCE

### Overall comments

Access to credit for the private sector in Danang seems to have improved in recent years, due to better implementation of the central government policies, better incentives for the local banks and an improvement in lending procedures. *Table 5* shows that the share of loans given by the Vietnam Bank for Agriculture and Rural Development (VBARD) branch in Danang to the private sector has

increased from 21.1 percent to 33.6 percent while those to SOEs have reduced steadily and substantially from 55 percent to 34.4 percent in the first nine months of 2004.

**Table 5: Outstanding loans in Danang 2002-2004, by ownership**

*In percent*

	Total loans			Short term <sup>a</sup>		Medium term <sup>b</sup>	
	2002	2003	2004 <sup>c</sup>	2002	2003	2002	2003
SOEs	55.2	46.2	34.4	82.5	74.5	60.6	43.7
Private firms	21.1	20.4	33.6				
<i>Shareholding companies</i>	<i>18.3</i>	<i>16.5</i>	<i>24.6</i>				
<i>Private</i>	<i>1.5</i>	<i>1.9</i>	<i>7</i>	<i>0.8</i>	<i>2.8</i>	<i>5.4</i>	<i>8.4</i>
FIEs	0.6	1	0.8				
Cooperatives	0.6	1	1.1				
Household enterprises	23.1	26.8	20.1	7.5	9.9	22.6	32
Industrial parks (IPs)	0.6	6.7	12				

*Source:* Danang DSO, 2004 & VBARD, Danang Branch.

*Notes:* (a) from VBARD, Danang Branch; (b) from all banks operating in Danang; (c) for the first nine months of 2004.

At the city level as a whole, a similar trend is observed in both short-term and medium-term loans (*Table 5*). There are some reasons for this improvement. Firstly, it is linked directly with the high growth of the private sector in 2003, leading to more demand for capital. Secondly, it was a result of better management of the bank itself, in terms of simplifying required procedures and a more customer-oriented business in the light of increased competition with a growing number of private banks operating in Danang<sup>1</sup>. Finally, it may be related to better evaluation of collateral assets coupled with the higher valuations of land assets as a result of the continuing boom in land prices. Interviews with various firms in Danang also provided similar impressions.

## **Current issues**

While this positive development is encouraging, it is important to note that this improvement in access to credit by the private sector seems to be not matched with the rate at which the sector itself (and hence its demand for credit) is growing. Many firms, especially SMEs, still find it difficult to borrow from the formal financial institutions, especially from state-owned commercial banks (SOCBs). A survey of 30 firms in Danang also shows that only a few firms use loans from SOCBs or from the formal financial institutions. Many firms still rely on informal sources of finance, such as from friends, relatives and other informal lenders.

<sup>1</sup> It is reported that many private banks in Danang are undertaking aggressive promotion campaigns, offering a lower borrowing rate to customers.

## **Seemingly over-prudent lending approach adopted by banks**

As seen elsewhere in Vietnam, a number of standard factors constrain bank lending to SMEs. Most commonly, banks are not satisfied with business plans that applicant firms submit with their credit and performance records. Also, bank staff often undervalue collateral assets, especially land for mortgage, or set credit limits low. Private firms interviewed complain that despite rapid growth in the private sector, private banks seem to be even more cautious than the state-owned commercial banks as far as providing loans to SMEs.

Interviews with local banks in Danang suggest that loan application procedures have been simplified significantly. Collateral requirements are still in place but the final decision by the bank relies mostly on financial viability of applicants. The joint stock Techcombank, for example, is reluctant to use collateral when it assesses clients' request for loans. Instead, it pays more attention on the loan applicant's business plan. There have been many instances when the bank reportedly advised borrowers not to take loans, despite the fact that borrowers satisfied all collateral requirements because the bank considered their business plan too risky.

Why do local private banks take this seemingly over-prudent lending approach? In this regard, they seem to be even more risk-averse than their state-owned counterparts.

Firstly, it may due to the lack of qualified bank staff with enough time and expertise to effectively undertake risk assessment of customer loan requests and to subsequently supervise and monitor their business performance. Secondly, it is not clear about the procedure of foreclosure in case of loan defaults and its effective enforcement. Private banks, in particular, do not want to be involved in this complicated and uncertain process, so they find it much safer not to take risks in the first place.

Worse, firms themselves are often accused of lacking transparency and failing to be consistent with their financial situation when this information is requested for the loan application process. Firms, on the other hand, complain that too much paperwork and too many signatures are required to complete loan application dossiers. Delays in providing required documents and papers due to cumbersome administrative procedures is reported to be one of the main factors discouraging SMEs to apply for loans from formal financial institutions.

## **Quasi policy-lending for construction of industrial parks and possible crowding-out impacts on SMEs' access to credit**

Another interesting observation from Danang that may help to explain why small firms have difficulty in accessing credit is a possible crowding out by the local government excessive drive for infrastructure building. Danang has been known for its intensive programs for infrastructure building, including promoting industrial zones. How these projects have been financed is less known. Many

projects are financed from the national budget and investment programs while the local government pays for others.

Another issue is that of industrial parks (IPs), which although financed by the local government, should be financially independent and are given full autonomy. On the other hand, the local government provides a series of fiscal incentives in order to attract domestic and foreign investors (Decision 50 and 51 are examples). Any shortfall in revenues to the industrial zone's authority due to these fiscal incentives needs to be financed from the local budget. The local government, in this regard, finds itself in a conflicted situation, trying to ensure the commercial viability of and financial support to IPs and using fiscal incentives as a means to promote new investment.

*Table 5* above shows that loans given to the city's industrial parks increased dramatically in recent years, bringing their share from marginal 0.6 percent to 12 percent in just two years since 2002. Whether it was a quasi policy-lending, where banks are giving loans to these local government initiated and supported projects under implicit pressure from the local government, or on purely commercial consideration remains to be seen, but its possible crowding-out impact on SMEs access to credit should not be underestimated. If we add these loans to those given to other SOEs, the reduction of loans given to the whole state sector becomes much less impressive as one may see at the first glance. The share of loans given to both SOEs and IPs in total, in fact remains as high as 56.4 percent, similar to the level in 2002.

This trend raises a serious question about the sustainability of the city development plans and its sources of financing given the fact that in Danang, like everywhere in Vietnam, most sources of development finance come from borrowing from the public via a simple bank deposit instrument. Access to scarce sources of credit may become even more of a problem if this trend of lending to industrial parks continues.

## **Recommendations**

Access to credit by SMEs in Da Nang has improved visibly during the past few years. However SMEs would be even better off following further improvements and simplifications of borrowing procedures and collateral requirements.

Private banking has emerged as an important source of financing for SMEs in Danang. While oversight and supervision is essential for the health of the financial sector, over-regulation generates serious costs, not only for the banks but also for the borrowing enterprises. It is important, therefore to provide these banks with more autonomy in developing new financial services.

Diversifying sources of finance for both business and infrastructure projects are essential to ensure that infrastructure project do not crowd out private business. Involving the private sector in infrastructure building with more diverse sources of finance beyond the city's boundaries should also be considered as an option.

Finally, training and information-sharing is important for building capacities of enterprises in market research and business planning so to improve their business

plan. Establishing an unified, easily accessed firm database would help banks in better monitoring and assessing firm's financial viability and would therefore facilitate loan approval.

## V. ACCESS TO LAND

### **Overall comments**

Land issues have never been easy in Vietnam, given its complicated history and many changes to its land management systems. The Land Law, enacted in 1993 was a good start, ensuring five basic rights on land use, but the effectiveness of its implementation is a subject of debate.

For years, there have been numerous complaints that the private sector and SMEs have been not equally treated in terms of access to land. In many cases, their requests for land were simply denied. Often, these enterprises have to lease land from SOEs who have been granted land for production purposes but did not use it effectively. With new infrastructure projects being implemented and rapid urbanization taking place, firms often must move to new locations, resulting in considerable cost and disruption to their normal business. Since the real estate boom restarted in 2000, land issues have re-emerged with more serious problems.

At first glance, land management in Danang appears to be better than that of many other areas, due to considerable local effort in addressing problems associated with land clearance, resettlement, land compensation and relocation for enterprises. Evidence is quite visible on the streets of Danang: a number of new roads industrial parks and residential areas have been built.

The provincial government in Danang has an important incentive to effectively deal with land management issues: Selling land has become a sizeable source of revenue for the local government.

*Table 6* shows that revenue, collected from granting land-use rights (selling land) shot up from a negligible VND7.5 billion in 2000 to VND1,369 billion in 2003. More than one-third of the local budget revenue comes from this source. Relying on this source of revenue for financing development in Danang may have serious consequences for the sustainable development of the city. However, this is not the focus of this study. We are interested in the implications of land management issues for SMEs in Danang.

**Table 6: Source of revenues for Danang local government, 2001-2004**

Year	2000	2001	2002	2003
<b>Revenues (VND billion)</b>	<b>1,680.3</b>	<b>2,118.8</b>	<b>2,517.4</b>	<b>3,969.9</b>
from SOE (percent)	13.97	11.13	9.06	7.86
SOE local	2.77	2.2	1.79	1.47
Private (percent)	5.92	5.39	5.16	4.48
Land use (percent)	0.45	9.37	20.67	34.5
External trade tax (percent)	21.32	28.12	29.21	14.6
<b>Land use (VND billion)</b>	<b>7.5</b>	<b>198.6</b>	<b>520.3</b>	<b>1,369.5</b>

*Source: Danang DSO, 2004*

## **Current issues**

### **Business concerns over possible commercial disadvantage of relocation**

Interviews with firms suggest that SMEs in Danang have not benefited as much as larger firms from recent land policies in Danang. SMEs tend to face higher costs of land leases because of rising prices. Furthermore, some firms have to move to a new location, which is often less favorable than the previous one in terms of commercial advantages. Many expressed the view that commercial value of location has never been and cannot be fully captured by any compensation schedules for land relocation offered by the local government.

While this issue is not unique for SMEs, they are nevertheless more vulnerable to location changes. Most SMEs are operating in services such as trading, retailing and supplying to households and other SMEs, and to be cost-effective this requires that they are located in high-density urban areas. The current setting of industrial parks with little linkages and clusters inside and surrounding the parks does not meet these requirements. Many SMEs are required to move far away from urban centers, leading to higher costs and fewer customers.

### **Uncertainty over the management policies of industrial parks**

For those who move into industrial parks, there are other disadvantages. Firstly, it is not SMEs that are on the target of the local government for attracting new investment. Decision 51 on promoting domestic investment, for example, provides two-year exemption for land lease fees and covers the costs of land clearance for those enterprises that have registered capital of more than VND30 billion (Article 3 and Article 5). Most SMEs, by definition are not eligible for this offer.

Secondly, many firms complain that the current planning of industrial parks does not take into account some possible negative effects of this industrial concentration, such as pollution and other problems associated with overcrowding. Some firms are concerned that very soon they will be asked to move again to a new location if these issues emerge and the government decides to take action. This creates more uncertainty and, if the relocation occurs, additional costs of resettlement for the SMEs. While this problem may affect all firms, regardless of their size, experience shows that SMEs are often the first to bear the costs and the last that receive benefits of any change that may occur.

## **To buy or not to buy: No option for firms**

Finally, firms in Danang may face different choices whether to buy or to lease land for their new location. In many other areas, Hanoi for example, firms, especially large concerns, may prefer to have a longer land-use contract by purchasing land at a “market price” from the Government. This helps them better plan their business strategy. In Tho Quang, a newly developed industrial park in Danang specializing in seafood processing, the local government asks firms to buy rather than lease land. However, for many SMEs in Danang, this does not seem to be a feasible option.

Given recent land price increases, coupled with limited access to formal credit and other sources of finance, purchasing land is not a desirable or affordable option for SMEs.

Furthermore, under the current arrangement within industrial parks, firms have to follow strict land-use regulation. Only 65 percent of entitled land can be used for production site. The rest should be for common utilization, such as internal roads, green areas, waste treatment facilities, fire-protection and security purposes. While these regulations are necessary to ensure safety and better working conditions for the firms and the whole complex in general, it is the lessees that bear the costs. It is estimated that this regulation would raise the already high costs of acquiring land for SMEs by at least 60 percent. Many firms are thus not excited about relocating to an IP.

The reality facing SMEs in Danang, as far as land issues are concerned, is that while the city is booming and its urban image is improving with new roads, bridges and industrial complexes, SMEs are retreating further into more disadvantageous, less developed areas with higher land costs. Industrial parks may offer solutions to some firms, but definitely not to all, especially those with limited budgets who need a location close to their customers. The local government is facing a difficult task trying to retain such firms in the city area because they provide employment to thousands of citizens, and at the same time provide these enterprises with affordable space in which to operate.

## **Recommendations**

Current administrative measures inadequately compensate SMEs displaced from their land. It is necessary to design a better and comprehensive compensation scheme that takes into account possible relocation losses borne by a firm due to disruption of business activities or loss of the commercial value of the previous location. It is worthwhile to consider a possibility of establishing a resettlement support fund with resources drawn from revenue that the local government collects by granting land-use rights or infrastructure projects in order to help firms to restart their business in a new location.

A more flexible option with more choices on how land can be leased or acquired should be open to all firms. In the long term, the whole concept of industrial zoning should be reconsidered to meet the need of non-manufacturing business and SMEs.

Furthermore, it is necessary to evaluate the effectiveness of Decision 51 and the impact of fiscal and land incentives on the commercial viability of industrial parks, on the one hand and on the SMEs development, on the other.

## **VI. TAX POLICY AND ADMINISTRATION**

### **Overall comments**

Tax policy is designed by the central government through the General Department of Taxation (GDT) of the Ministry of Finance (MoF). Tax rates and rules that govern collection should thus be uniform across Vietnam, but in reality the practice of tax administration by the provincial and district governments varies widely across the country. A number of factors combine to create this divergence in implementation, but two need to be highlighted.

Firstly, the central tax authorities set tax collection targets to provincial tax offices. Money collected under certain categories must be passed on in their entirety to the central government to meet annual targets while other tax receipts are either shared between the province and the center or retained entirely by the provinces. But beyond meeting the targets, local tax authorities have considerable autonomy over assigning tasks and defining additional objectives, and these can have the effect of producing different patterns of collections across different administrative units.

Second, it is generally accepted that there are noticeable differences across provinces in terms of the local tax authority's capacity to interpret and implement tax rules. This difference in the "quality" of governance can produce predictable and transparent enforcement in one province and opaque and uncertain enforcement in another.

In this section, we present and analyze some practical issues of tax policy and administration, which are constraining local business competitiveness as experienced by the private sector in Danang.

### **Tax policy issues**

#### **Uncertainty over frequent changes in tax policies**

Firms report that tax rules change frequently and this regulatory instability represents a source of uncertainty for businesses. The problem is not so much that rates are changed, as these have shown a downward trend over time and so presumably would benefit businesses. Rather, the rules that govern which items fall under which categories and rates are both uncertain and may change, leaving companies exposed to unanticipated tax liabilities and opportunity costs for having entered into a contract prior to the effective date of the reduction rather than deferring it till after the change.

### **Box 2: Example – Import duty on steel**

In an interview with the director of a general trading joint-stock company in Danang, we were told that his company had imported steel when the import duty was levied at 10 percent. Shortly after, the tariff was lowered from 10 percent to 5 percent. Paradoxically, though the reduction was of good intent and will benefit businesses in the long run, the decrease placed his company at the risk of losing sales contracts to competitors who managed to import the material at 5 percent and hence had a competitive advantage over his company by offering customers lower prices. This director also added that keeping up with regulatory changes are occupying a considerable amount of management time which could, otherwise, have been used more wisely by concentrating on the core business of the company.

### **Box 3: Example – VAT treatment applicable to commissions**

Until late 2003, according to Circular 122<sup>2</sup>, commissions earned by a sales agent who sells goods at prices fixed by and on behalf of the principal were not subject to VAT declaration and payment. In December 2003, however, the MoF issued a new Circular 120, under which, such commissions were now subject to VAT requirements<sup>3</sup>. Accordingly, the sales agent was required to file VAT returns and remit VAT monthly. Eight months after, in August 2004, this circular was once again revised by a new Circular 84, whereby, commissions earned by a sales agent who offers postal, insurance, lottery and air-ticket services at prices fixed by the principal are no longer subject to VAT requirements<sup>4</sup>.

On the one hand, it is well acknowledged that regulatory changes are inevitable, given that Vietnam's regulatory system remains underdeveloped and various reforms are under way. On the other hand, such examples show that the changes, if frequent, may have unintended consequences. Management finds it harder to plan activities, make forecasts and projections, design contracts and ensure compliance.

### **10 percent deductibility limit on marketing and advertising expenses**

Current Business Income Tax<sup>5</sup> regulations limit the deductibility of marketing and advertising of expenses to 10 percent of total allowed expenses. Depending on the

<sup>2</sup> Point 2, Item II, Part C – Circular 122/2000/TT-BTC issued by the Ministry of Finance on 29 December 2000, providing guidance on the implementation of Decree 79/2000/ND-CP on VAT.

<sup>3</sup> Point 2, Item II, Part C – Circular 120/2003/TT-BTC issued by the Ministry of Finance on 12 December 2003, providing guidance on the implementation of Decree 158/2003/ND-CP on VAT.

<sup>4</sup> Item 8 – Circular 84/2004/TT-BTC issued by the Ministry of Finance on 18 August 2004, amending and supplementing Circular 120/2003/TT-BTC.

<sup>5</sup> These regulations include: (i) Law on Corporate Income Tax adopted by the National Assembly on 17 June 2003, (ii) Decree 164/2003/ND-CP of 22 December 2003 of the Government providing detailed implementation guidance for the CIT Law, and (iii) Circular 128/2003/TT-BTC of 22 December 2003 of the MoF detailing Decree 164.

type of business, total deductible expenses for this purpose may not always include the cost of goods sold.

In Ho Chi Minh City, many members of the Young Business Association have claimed this limit the biggest restriction to their competitiveness. This issue is also a hot topic in the media and in many business forums. We had a discussion on 15 October 2004 with Luu Duc Sau, senior officer for Tax Collection Support at the Danang Tax Department about the situation in Danang and were told that in his experience, this limit does not seem to be binding for SMEs in Danang, although more problematic for foreign invested firms.

Our interviews with several small enterprises and a review of survey results show a mixed conclusion. Some enterprises seem not to be worried about this limit. Some, though having not reached the limit yet (they incurred about 5-8 percent), suggest that the basis of calculation on other expenses is not appropriate since expenses are incurred to earn revenue. Thus the limit, if imposed, should be based on net revenue instead of other allowable expenses.

Other enterprises that have incurred more than the limit (up to 15 percent) complained about the unreasonable uniform limit regardless of the nature of business. These businesses argued that the importance of this expense differs widely for a manufacturing company, a trading company and a consulting service company. One private trading SME requested that the limit, if retained, be based on the total expenses inclusive of cost of goods sold rather than currently exclusive of cost of goods sold. Another surveyed trading and construction company wrote that “enterprises should be granted autonomy over their operations and the State should not intervene by setting a limit”. One small petrochemical subsidiary suggested the limit be removed because its industry is highly competitive due to the presence of foreign-owned firms and joint ventures.

It is believed that the tax authorities set the upper limit since they fear that businesses may evade or avoid tax liabilities by overstating this expense, thereby understating taxable income. However, in our opinion, capping marketing and advertising expenses may unfairly penalize expenses that are essential for competitiveness and distorts the real income tax. The actual effective tax rate would be much higher than what the statutory tax rate may look and this, in turn, creates a tax burden on honest businesses.

Furthermore, this practice of capping marketing and advertising expenses seems to be a peculiarity of Vietnam. We note that other countries in the region such as Malaysia, Indonesia, the Philippines, Thailand, Australia, New Zealand, Singapore, Hong Kong, Taiwan, South Korea and China<sup>6</sup> do not impose such limitations.

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<sup>6</sup> No limit if the company logo is on the advertisement.

## **Tax administration issues**

### **Lack of transparent and consistent treatment of supporting documents for tax returns**

Justifying expenditures for deductibility is a problem commonly faced by businesses during visits from tax auditors. Current regulations<sup>7</sup> provide that tax-deductible expenses must be reasonable and valid. The tax authority has the power to consider the reasonableness of such revenue and expenses. There seems to be no general test or criteria for tax deductibility. Instead, a list of 14 types of deductible expenses is laid out in the regulations.

In accordance with these regulations, in order to obtain a tax deduction for an expense, an enterprise is required to have proper and valid documents to support the purchases, for example, an official MoF invoice.

In reality, what constitutes a conforming set of supporting documents may be negotiable, given the fact that the final word often lies with individual tax officers. Another reason, as it should be acknowledged, is that in most developing countries a huge informal sector operates outside the tax net such as farmers and household businesses. Since having all expenses claimable is crucial for a company's bottom line, thus its competitiveness, it is vital to get a tax officer to agree on expenses as much as possible. This concentration of discretionary power with the tax officer leaves open the possibility of abuse.

#### **Box 4: Example – Allowable deduction of utility expense**

A Finance and Accounting deputy manager of a textile and garment company in Danang told us that her company was in a debate with a local tax inspector to finalize the deductibility of a utility expense.

According to the lease contract with the landlord, her company was to bear utility costs. However, in scrutiny of expenses and calculation of taxable income, the tax inspector disallowed the expense for deduction, arguing that the utility bill was in the name of the landlord, not the company. This implies that only the landlord can claim deduction of this expense. The company disagreed and as a counter-argument, referred to the utility clause of the contract.

We were told that the conflict was resolved through negotiation with the tax officer, who said he agreed to compromise with the company just because that was the first time the company had made this type of mistake.

The above example shows the rules are not only complicated, but also there are differing attitudes toward implementation and interpretation. Such a mismatch between complexity and ambiguity in official requirements, and an SME's limited

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<sup>7</sup> These regulations include: (i) Law on Corporate Income Tax adopted by the National Assembly on 17 June 2003, (ii) Decree 164/2003/ND-CP of 22 December 2003 of the Government providing detailed implementation guidance for the CIT Law, and (iii) Circular 128/2003/TT-BTC of 22 December 2003 of the MoF detailing Decree 164.

capacity to complete all of the required documentation creates an environment in which firms may prefer to interact informally with the local tax collector than try to fulfill the legal tax obligation.

**Box 5: Example – Inconsistent treatment by tax officers of supporting documents for VAT refunds**

A finance and accounting deputy manager of a SME said that previously, it took her company four to six weeks from the first application to get VAT refunded. However, her company has a claim pending of more than VND1 billion relating to VAT in 2003.

The tax officer explained that the reason for the delay was that she had failed to submit a customs receipt for input VAT payments on imports. What she had on the submitted tax file was only the Treasury's receipt of that VAT remittance. This is not sufficient as confirmation from the Customs was required.

The issue stems from the fact that the import was delivered to and received by her company's customers in HCMC at Saigon Port, thus the customs clearance occurred in HCMC upon the settlement of input VAT in Danang. In previous VAT finalizations with local tax officers in Danang, the Treasury receipt notes were accepted as adequate evidence for input VAT credit so she did not ask for customs confirmation. The divergent treatment by different tax officers caused the delay of VAT refund which could have been avoided had they been consistent in verification procedures.

She has sent out the Treasury receipts to the HCMC Customs in the hope that they would check their 2003 files again to issue the confirmation. This process would take further considerable time and it would take much longer until her company could really get the VAT refunded.

In that example, we have also seen the absence of active communication and coordination between the tax and customs authorities and how it has caused problems for enterprises.

The current practice assumes the responsibility to obtain a customs receipt is with the enterprise. Thus, if the enterprise does not request it, they may not automatically have it, especially if they are located elsewhere. Such problems might have been avoided had there been a system in place where customs authorities are consistently required to send by registered mail the confirmation to the enterprise (with the postage borne by the enterprise).

**Information outreach on regulations**

Until now, mailing out copies of new regulations remains the most common method that the local tax office has been using to disseminate information to enterprises. Since early 2004, free training courses have been organized on a regular basis to educate entrepreneurs on tax law and regulations. Monthly introductory courses for newly established enterprises and twice-yearly legal

update courses for all local enterprises have also begun. In an attempt to give more timely advice to enterprises, the local tax department also set up a Q&A section comprising eight staff. According to Mr. Sau, each staff member handles about 20 calls per day. This section is separate from the complaint handling section and is mandated to respond to telephone inquiries by enterprises on tax law and regulations.

According to our interviews with local entrepreneurs, many are concerned that simply mailing out information is inadequate, since there is no assurance that the mail will reach them. One interviewed entrepreneur told us about the time she wasted as she was required to prepare the return again because she had done it in an old-fashioned format. The requirements had been significantly changed in a new regulation, but somehow her company did not receive the mail about this new regulation.

We also learnt from discussion with Mr. Sau that the participation in training courses remains limited, especially that of newly established enterprises. Frequent changes in tax regulations have made the tax trainers' work even more challenging as training courses would ensure understanding and compliance by enterprises. Yet, "only 50-70 percent of the invited participants turned up", he said. Several companies that we visited and interviewed admitted they seldom attended the courses because they were too busy.

A better way, but not yet attempted by the local tax office, is to disseminate legal updates and guidelines via email. Though not many SMEs can afford Internet access, many have email accounts. With this method, the local tax authorities can communicate updates to enterprises efficiently and quickly while at the same time making sure the information has reached the recipients properly by requesting a one-click acknowledgement of receipt. Only in the case of no email available would the tax office send the documents by normal mail.

This may be extended to the Q&A function of the Tax Department as well. Inquiries can be emailed to the Tax Office and responded to by email without the need for the taxpayer's physical presence at the tax office.

## **Recommendations**

As tax policies are designed by the central government, it is beyond the capacity and power of the local government to resolve tax policy issues. Any removal of the 10 percent deductibility limit on marketing and advertising expenses, for example, is subject to approval by the central government. For that reason, this provincial study report intends to concentrate its recommendations on tax administration issues for consideration by the local government of Danang.

In many ways, the assessment by the Danang business community of tax enforcement seems to be consistent with the way tax officials describe their relationship with the business community, as it is understood that there is a high degree of non-compliance through under-reporting and under-invoicing.<sup>8</sup> Indeed,

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<sup>8</sup> This mutual finger pointing is not unique to Vietnam. Research of taxpaying practices and opinions among small businesses in Australia, for example, found that entrepreneurs perceived that

it seems fair to suggest that that the experience in Danang may be not be significantly worse than one might find elsewhere in Vietnam. But even if tax administration in Danang is not a problem that is unique to this province, local officials may be missing an opportunity to be more pro-active in addressing one area of governance that SMEs continuously point to as problematic.

A number of mechanisms may be available that would satisfy the local tax office's need to satisfy targets set in Hanoi even while achieving the broader objective of creating a regulatory environment that encourages investment. These include:

### **Tax self-assessment**

Already being piloted in Ho Chi Minh City and Quang Ninh, a self-assessment system based on the presumption of compliance and expedited service has been shown in some places to meet revenue expectations while dramatically lowering costs to both business and government.<sup>9</sup> According to tax officials in Hanoi, there is nothing preventing other provinces from attempting this experiment, and while officials may be reluctant to implement such a radical departure without evidence of success in Vietnam, the local tax authorities could begin designing the regulatory framework should the initial results from the two pilot projects be positive. Given the concerns over tax administration expressed by SME owners in Danang and elsewhere in Vietnam, provinces that move early to establish a business-friendly tax administration will establish a significant competitive edge over neighboring provinces that continue to use tax enforcement strategies that encourage side-payments and negotiated evasion. Such irregularities place a burden on all tax-paying businesses.

### **Tax information and compliance services for SMEs**

A common refrain, repeated by both government officials and business representatives, is that non-compliance among SMEs occurs to some extent due to the inability of the enterprises to understand what the tax code demands and to meet the expectations of the local tax office. Some tax offices are more pro-active regarding changes in rules, including the release of periodic announcements, sometimes in a CD-ROM format, or via email, but it is not clear how much of this is feasible for Danang.

Without establishing a publicly funded tax accounting service, the provincial government may be able to do much more to help interested SMEs properly submit their tax returns. Already, expenses for private tax services are tax-deductible, but this facility apparently is not sufficient to enable firms to qualify

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they were being treated unfairly by the Tax Office but, at the same time, they acknowledged paying less than their fair share of tax ("Small Business Individuals: What do we know and what do we need to know?" Eliza Ahmed and Yuka Sakurai, ANU and the Australian Taxation Office, Centre for Tax System Integrity, Working Paper No. 27, December 2001).

<sup>9</sup> One must be cautious, however, not to expect significant increases in revenue. While this result has occurred in some instances where self-assessment has been tried, the change in revenues depends on a number of factors, including the effectiveness of the previous tax collection strategies.

for the expedited service.<sup>10</sup> A combination of greater information outreach to SMEs and a more reasonable threshold to qualify for expedited VAT refunds might create an environment within which firms that made good-faith efforts to comply would see their investments (in tax submissions) rewarded.

## **VII. REGULATORY DECISION MAKING**

### **Overall comments**

Looking at the recent intensive investments by the local government in developing new and rehabilitating existing infrastructure, Danang's economy appears to be poised for more rapid economic growth. Unfortunately, the public sector investments have not yet generated the increase in new private sector investment that had been anticipated. The preceding sections have identified a number of impediments including, in particular, access to credit and access to land. In other words, this gap of expectation may be explained by the fact that the upgrading of the physical "hardware" of the economy has not been matched by similar improvements in the governance "software" which includes its approach to regulatory reform.

Ultimately, the Danang government will need to take responsibility for enhancing the attractiveness of the local business environment but it would be a mistake to think that government agencies can do this alone. Indeed, local governments are rarely successful at meeting the demands of the private sector without designing and implementing mechanisms that explicitly solicit and incorporate input from the private sector regarding both the regulatory system (e.g., the quality of rules and regulations, the standards of the policy making process, the efficiency of public-private dialogue mechanism, and the effectiveness of dispute resolution system) and the proper delivery of important public services (e.g., the ease and cost of access to tax and accounting consulting, the city's master-plan information, and business registration advisory service.).

In this section, we analyze some practical issues of the prevailing consultative and regulatory decision making processes in Danang and share our points of view on how to align the current practices with best international practices in regulatory reforms.

### **Current issues**

#### **Lack of regulatory impact assessment**

Regulatory impact assessment is not a new concept for policymakers in Vietnam. However, this process has rarely been properly or understood thoroughly. It is generally said that in any discussion of a draft, while people often argue over the accuracy of the language, few question the draft's objective or challenge its

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<sup>10</sup> Indeed, if it is practically impossible to qualify for the expedited refund service, businesses may have no incentives whatsoever to invest in additional tax accounting services, as they will in any event need to await the Tax Office's determination.

necessity. In cases where an impact analysis has been conducted in Vietnam, it is not close to a substantive cost-benefit analysis. Rather, it takes the form of a “motherhood statement” that the regulation or policy would bring benefits to the business community or improve the business environment. It lacks a thorough review and assessment of the economics of a regulation.

There are a number of key principles underlying good regulatory review, and these principles should be applied universally across Vietnam:

First, it is important that there are clear objectives for a particular government policy or regulation. The objective should always be to solve a problem. If there is no problem, then there is no need for a regulation.

Second, governments should always consider non-regulatory alternatives to solving problems and should only regulate when it can be shown that there is no other alternative.

Third, before a regulation or policy is implemented, it must first be shown to generate a net benefit for the community. That is the use of cost-benefit analysis to investigate whether the benefits of the regulation exceed the costs.

Fourth and most importantly, it is crucial that the broad range of stakeholders affected by regulations should participate in the policy process. For this reason, consultative process is very critical to obtain public support.

How closely has the local government of Danang gone through such principles when drafting their policies on, say, investment incentives, tax administration or land administration? Although the objectives of these policies have been clearly established – to promote provincial economic development – it seems that little analysis or regulatory review has been undertaken. The cost to access land in the IPs, both in time and money terms is believed to well outweigh the benefits of being located therein. Thus the IP policy turns out to be not as effective as it has been expected.

The incentives on foreign direct investment (FDI) are another example. They have not seemed to draw as substantial FDI inflows to the city as the local government had expected. Binh Duong province offers little in the way of fiscal incentives, yet investment capital has been pouring and the oft-cited reasons – the attraction of the province’s effective administrative reform. Deregulation, rather than any additional incentive, regulation or policy, has been the major driver in Binh Duong’s success.

### **Consultative process of “form” over “substance”**

International best practice in policymaking enshrines a consultative process as a key principle for the success of any policy. Current applicable laws in Vietnam also stipulate that the drafting agency must seek public opinion. Current practices of regulatory policymaking in Vietnam shows that only laws, ordinances, directives and decrees are required to obtain opinions from concerned stakeholders. That requirement does not apply to other forms of regulations, such as ministerial circulars and local government rules and policies. Thus, it is often

observed that more weight is given to soliciting the opinions of state-owned enterprises, less to those of private enterprises, and very little to those of SMEs.

So far, public-private dialogues seem to be a conventional consultative instrument most used by the local government. However they are often convened to collect the feedback of the business community on existing rules and regulations rather than to solicit viewpoints on a new or intended regulation. For instance, all the eight tax dialogues held by the Tax Department with about 1,000 SMEs in Danang so far in 2004 were aimed to collect opinions on current tax policy and administration.

The Vietnam Chamber of Commerce and Industry (VCCI) has been playing an active role in communicating business concerns to the governments at both local and central levels, by hosting public-private dialogues or compiling a consolidated report that captures opinions of the vast business community. However, there is widespread skepticism that these inputs are acted upon by policymakers. In other words, the consultative process still looks formalistic and the substance of the inputs gathered in the process are yet to be effectively taken up.

## **Recommendations<sup>11</sup>**

### **Regulatory impact statement**

We recommend that all new policies and decisions in Danang must undergo a rigorous regulatory review process before being drafted or implemented, and this should result in the production of a regulatory impact statement (RIS)

The role of the RIS that it is to provide an assessment of the costs and benefits of the regulatory proposal being undertaken and to identify all feasible alternatives and analyze the merits of those alternatives relative to the actual regulatory proposal. In addition, the RIS should be able to effectively communicate this information to the public and thus allow for a more informed process of consultation and participation.

In general, the preparation of a RIS should be required wherever a proposed regulation in Danang imposes a material economic or social burden on a sector of the community. The responsibility of preparing a RIS should be placed upon those proposing the legislation.

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<sup>11</sup> The content of this section has been drawn from Research Report “Business Regulation Reform: A Toolbox for Vietnamese Policymakers”, Raymond Mallon, October 2004.

### **Box 6: Content of a Regulatory Impact Statement**

Regulatory impact statements for Danang should include:

- A statement of regulatory objectives
- A statement of the nature and the extent of the problem to be addressed through regulation
- An outline of the proposed rules on the expected effect
- A statement of the costs and benefits of the proposed regulation
- A statement of alternatives to the regulation
- A statement of costs and benefits associated with the identified alternatives
- A statement as to why the identified alternatives are not preferred
- An explanation that the process of developing the regulation involved participation by all stakeholders

#### **Regulatory impact assessment team**

To undertake the RIS, a team should be formed comprising officers from relevant technical departments, representatives from the People's Committee, legal and economic experts from local universities and key stakeholders from the business sector, consumer groups and the wider community.

Unaccustomed to justifying proposals for legislation, the provincial government in Danang is likely to resist any new requirements to produce impact statements and to bring non-government outsiders into the policy process. Objections are also likely on the grounds that the province does not have the requisite human, physical or financial resources.

It is therefore important to demonstrate to the provincial government that producing impact statements does not need to be a complicated and expensive affair, and that undertaking even the most elementary of reviews can generate considerable benefits for the community and the government by way of improved regulatory process and outcomes. As noted by the Organization for Economic Cooperation and Development (OECD) many of the benefits of carrying out regulatory reviews come, "*... not from the precision of the calculations, but from the action of analyzing, questioning, understanding real world impacts and exploring assumption*" (OECD, 1995).

Initially, impact statements in Danang should focus on three simple tasks:

- Establishing the objectives of the regulation
- Consideration of possible alternatives (including those not involving regulation)
- Identifying winners and losers.

Over time as capacity develops and governments become more accustomed to the regulatory review methodology, policy choices can be increasingly assessed in cost-benefit terms.

## Checklist for regulatory decision-making

Going forward to more formal and systematic thinking about the need for new regulations, we believe that the following checklist may provide a useful starting point. It is drawn upon OECD best practice of regulatory decision-making that improves regulatory quality to facilitate business development.

As efforts to continue improvements to regulatory quality should be an ongoing process, we recommend that policymakers regularly revisit the checklist before a regulation is decided upon.

### **Box 7: OECD Checklist for Regulatory Decision Making**

1. **Is the problem correctly defined?** The problem should be precisely stated, giving evidence of its nature and magnitude, and explaining why it has arisen (identifying incentives of affected entities).
  2. **Is government action justified?** Document evidence that government action is justified, the likely benefits and costs of action, and assess alternative options for addressing the problem.
  3. **Is regulation the best form of government action?** Review regulatory and non-regulatory policy options, taking account of costs, benefits, distributional effects and administrative requirements.
  4. **Is there a legal basis for regulation?** Regulatory processes should respect the ‘rule of law’. All regulations should be authorised by higher-level regulations, be consistent with treaty obligations, and comply with other relevant legal principles.
  5. **What is the appropriate level (or levels) of government for this action?** What is the most appropriate level of government action? Where multiple levels are involved, systems for coordinating actions should be specified.
  6. **Do the benefits of regulation justify the costs?** Estimate the expected costs and benefits of regulatory options, and make these estimates available in an accessible format to decision makers.
  7. **Is the distribution of effects across society transparent?** Assess, and make transparent, the distribution of regulatory costs and benefits across social groups.
  8. **Is the regulation clear, consistent, comprehensible and accessible to users?** Make sure that rules will be understood to all concerned: the text and structure of rules should be as clear as possible.
  9. **Have all interested parties had the opportunity to present their views?** Regulations should be developed in an open and transparent manner, with effective input from stakeholders such as businesses, employee organizations, other interest groups, or other levels of government.
  10. **How will compliance be achieved?** Assess the incentives and institutions by which the regulation will be implemented, and design implementation strategies to maximize compliance efficiency.
- Source: Summarized from OECD, 1995*

## Best practice principles for consultation

Regulatory changes are irrelevant if they are not implemented. In turn, successful implementation depends on broad public support. Consultative processes help build public support, public confidence in the regulatory system and enhance voluntary compliance. On that belief, we present below the best practice in consultation processes commonly adopted by OECD countries for your reference.

## **Box 8: International Best Practice Principles for Consultation**

### **Consistency and flexibility**

- Consultation programs must be flexible enough for use in very different circumstances, while also meeting minimum standards, to ensure consistency and confidence in the process.
- Minimum standards allow all parties to assess whether the consultation has been properly undertaken, and provide clear guidance for regulatory policymakers.
- Adoption of a range of strategies and approaches will offer broad access to all interested parties, and maximize information gathering.

### **Consultation should be timely, balanced, broadly based and an ongoing process**

- Early consultation helps identify optimal policy options.
- Consultation is most effective when information is made available early. Consultation documents should clearly identify both the policy objective and a wide range of alternatives.
- Provision of preliminary impact assessments to the public will facilitate substantive dialogue.
- Maximizing participation (facilitate access by less organized interests), minimizing discretion in deciding who participates, and making information widely accessible can be facilitated by:
  - Innovative information dissemination, including use of the public media and information technology;
  - Drafts set out in plain language and using reader-friendly formatting; and
  - Clear identification of key issues and their implications for stakeholders.
- Structuring continuing dialogue enhances the benefits derived from consultation.

### **Transparency and responsiveness**

- A systematic consultation policy gives the public an understanding of what opportunities can be used during the consultative processes. Consultation is more effective when organizers:
  - Clarify why information is needed;
  - Explain the process of decision making and opportunities for participation;
  - Ensure public comments are appropriately taken into account; and
  - Respond substantively to public comments.

### **A habit of consultation should be made part of administrative culture**

- Consultation policies must be explicitly supported at high political levels, and reinforced with staff training, incentives and resources.
- Regular monitoring, evaluation and improvement of consultation arrangements are important.

*Source:* Summarized from OECD, 2002, pp.162-165

It is recognized that there are many benefits from enhancing the participation of the private sector in the promulgation of policies and regulations. The most fundamental benefit to government agencies is the information that is gained regarding the likely impact of new government decisions. Such information can help public agencies avoid unintended consequences. Obviously, private sector interests should not be allowed to dominate or dictate policy and governments are wise to interpret business comments and suggestions in light of their own interests. But undertaking economic regulation without adequate input from the affected business community is a common cause of poor economic governance.

## VIII. CONCLUSIONS

This study provides some analysis of key regulatory problems constraining the local business competitiveness in Danang. The research has been carried out as a joint effort by the CMCC, VCCI Danang Branch and VNCI staff and consultants. The analysis is based on the issues identified from a small-scale survey of 50 firms in Danang and firm-level interviews, complemented by follow-up discussions with local government agencies such as the Danang Department of Planning and Industry and the Danang Tax Department.

Among those concerns, access to land stands out as the most serious constraint in spite of the establishment of industrial zones. Though the banking system and tax administration has been gradually improved, access to bank loans, lack of transparent criteria on supporting documents for VAT credits and BIT expense deductibility, coupled with the unmet need of the enterprises for information outreach on tax changes are still regarded by the local businesses to restrain their competitiveness. In addition, the regulatory decision-making process is yet to align with international generally accepted practice, limiting the positive impact on the local business environment.

We all agree that regulation is a pervasive feature of modern state governance. Of particular importance are regulations that govern economic activities. However, it has become clear that not only over-regulation but also poorly designed regulations, even with the best goals and intentions, can injure economies and distort trade, investment and other business activities. For this reason, in this report, we have not only identified and analyzed key regulatory constraints to business competitiveness, but also proposed recommendations to mitigate the negative impact of the identified problems. The most critical recommendation is the need for a proper regulatory impact analysis. It should be documented and distributed to stakeholders in the consultative process.

This study is about Danang, and the size and nature of problems may vary in the experience of business communities elsewhere in the country. However, it is expected that the recommendations put forward in this report will be useful for local governments not only in Danang but also in other provinces in their on-going regulatory reform that enables business environment.

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