

SUMMARY PROGRAM IMPACT ASSESSMENT

I. Introduction

1. This program's impact assessment (PIA) supports the Second Small and Medium Enterprises Development Program, with specific emphasis on Subprogram 2. ADB utilizes policy-based lending to support policy reforms that enhance its DMC's growth prospects and economic efficiency. These policy reforms, which are consistent with the ADB's strategy for the DMC as well as the DMC's own development strategy, are also set forth in the Development Policy Letter which is a part of the Report and Recommendation to ADB's President (RRP). The overall size of a policy-based loan is determined primarily by the development financing needs of the DMC at the broad macroeconomic level.¹ The actual costs of the reforms are indicative estimates and do not necessarily determine the size of the policy-based loan. This Program Impact Assessment (PIA): a) provides a summary of the Government's development financing needs; b) documents the formulation of the SMEDP2; c) and provides estimates of the costs and benefits of the subprogram. The methodology used for this PIA follows the regulatory impact assessment (RIA) tool commonly used to assess the impact of proposed regulations and other interventions on the economy.²

2. The remainder of this PIA is as follows: Section II summarizes the development financing needs of the government. Section III presents a brief summary the methodology used to prepare the PIA. Section IV: a) summarizes the problem; b) discusses the range of feasible policy options, including regulatory but also non-regulatory alternatives for the achievement of the reforms objectives, c) identifies the intended impact and outcome of the SMEDP 2 (SP2), and d) estimates the potential benefits and costs of the SMEDP2.

II. Development Financing Needs

3. The government has requested a loan of \$50,000,000 from ADB's Special Funds resources to finance the project. The loan amount is based on the financing needs of the government, the strengths of the policy package, and its development impact. Viet Nam's gross financing needs remain high. In 2013, with a budget deficit target of 4.8%, the government will need to borrow VND 162 trillion (\$7.8 billion). In 2012, deficit financing was obtained from domestic sources (44%) and external sources (56%), of which some 84% was accounted for by ODA. Assuming a similar distribution for 2013, the government will borrow an estimated \$3.7 billion through Official Development Assistance to close the budget gap.

4. This impact assessment estimates the reform program adds approximately \$900 million to GDP, equivalent to some 0.6% of GDP at 2012 current prices. The benefits arise from improved allocative and operational efficiencies at the regional government level. The costs of the reform program in terms of government administrative, enforcement and fiscal costs are indicatively estimated at some \$465 million, or approximately 0.3% of GDP. The subprogram is expected to provide a net benefit to the economy of approximately \$445 million.

¹ OM Section D4/BP issued on April 1, 2013.

² See for example, Office of Best Practice Regulation (2009), *Best Practice Report 2008-09*. Department of Finance and Regulation, Australia Government, Canberra; Treasury (2009), *Regulatory Impact Analysis Handbook*, New Zealand Government, Wellington; or OECD (2008), *Introductory Handbook for Undertaking Regulatory Impact Analysis*. Brussels.

III. Program Impact Assessment: Methodology

5. As a tool, the PIA provides a flexible methodology for the systematic analysis of reforms to ensure they achieve their defined policy objectives in a cost effective manner. As a process, PIA incorporates evidence-based approaches to regulatory development and policy formulation, considering available options for reform through consultation and regular questioning of policy assumptions. PIAs identify the channels of policy impact, both positive and negative, thus essentially providing a qualitative description of policy reforms, but also quantifying in dollar terms, to the extent possible, the impact of reforms. The PIA methodology assists in minimizing adjustment costs from reforms, and helps justifying the proposed regulatory reforms on the basis of the expected net benefits. To achieve these objectives, this PIA is structured along four steps: a) definition of the problem and the regulatory objective of the program; b) the definition of the expected impact and outcome of the proposed program; c) the assessment of costs and benefits.

6. In the assessment of costs and benefits of reform options, the PIA will aim to identify the full range of impacts, including fiscal, economic, social and environmental. The PIA will, to the extent possible, quantify both benefits and costs from the proposed program in order to provide an estimate of net benefits. In general, the costs to government and statutory agencies will be classified as; administrative costs, enforcement costs, and direct fiscal costs. Administrative costs represent those costs incurred by the government and relevant statutory agencies in implementing the program, while enforcement costs represent those costs incurred by government and relevant statutory agencies in enforcing compliance and monitoring the implementation of the program. Direct fiscal costs include the costs of establishing new agencies or expenditure programs, budget increases, forgone revenue collection, etc.

7. In presenting the results of the PIA, both a summary of the main costs and benefits from the expected reforms, as well as the key assumptions underlying the estimates will be offered. The PIA should: a) show indication that the net benefits from the proposed program outweigh the costs and maximize net benefits, and b) that the loan amount is commensurate with the adjustment costs of the reforms. The estimation of costs from the reforms relies, when possible, on government estimates and official budget figures or budget proposals included in planning documents. For the estimation of benefits, specifically for the estimation of savings from simplification of administrative procedures, specific assumptions are made in section F below.

IV. Program Impact Assessment: The Developmental Impact of the Program

8. This section summarizes the problem, identifies the intended impact and outcome of the SMEDP2 (SP2), options reviewed, stakeholders consulted, and estimates of the potential benefits and costs of the SMEDP2 (SP2).

A. Definition of the Problem

9. Healthy levels of private investment will continue to be essential in order to achieve the 7%-8% economic annual growth rate and the 8 million new jobs targeted under Viet Nam's National Socio-Economic Development Strategy 2011–2020. Viet Nam's record of GDP growth over the last two decades has been impressive, culminating in its reaching middle-income country status in 2010 when its per capita income exceeded \$1,000.

10. **Structural impediments constrain the government.** Against its excellent record on economic growth, Viet Nam has displayed serious macroeconomic instability since 2007, even

before the beginning global economic and financial crisis. The large inflow of capital following Viet Nam's accession to WTO revealed structural weaknesses within the country's macroeconomic management systems. This instability has translated in a combination of persistently high inflation rates, decreasing levels of foreign exchange reserves as a result of pressure on the Vietnamese Dong, and large domestic capital outflows. In addition, increasing fiscal deficits and public debt have raised doubts on the government's ability to manage Viet Nam's economy and debt. As a result, financing costs have increased due to sovereign debt rating downgrades by all the major credit rating agencies.³

Table 1. Macroeconomic Indicators for Viet Nam and Comparison Countries (2004-2009)

	Viet Nam	China	Indonesia	Malaysia	Philippines	Thailand
Fiscal Policy (% GDP)						
Overall fiscal balance	-5.8	-0.9	-0.9	-4.3	-2.1	-1.1
Fiscal Revenue	26.8	18.4	17.9	21.6	15.5	18.3
Gross capital formation	36.2	40	22.6	22.2	17.7	22.3
Public debt	46.9	20.1	39.1	43.8	64.7	43.8
Monetary Policy (% per year)						
Growth of money supply M2	32.2	19.4	14.5	15.1	12.3	7
Growth of domestic credit	37	15.7	12.4	8.1	7.1	4.4
Balance of payment						
Current account balance (% GDP)	-5.7	7.7	1.4	15.5	3.5	2.2
Net FDI (% GDP)	6.8	3	1.6	3.4	1.6	3.8
FX Reserves (Months of imports)	3.5	18.9	7.9	7.9	6.9	7.5
GDP Growth and Inflation (%)						
GDP growth	7.4	11.1	5.5	4.5	4.7	3.5
Consumer price index (CPI)	10.2	2.9	8.4	2.7	5.8	3.1

Note: Figures are averages for the period 2004-2009

Source: Economist Intelligence Unit. Table from ADB (2012) Viet Nam Critical Development Constraints

11. The growing trade and current account balances add another concern to the macroeconomic picture. The composition of Viet Nam's imports do not seem to fully justify such a trade imbalance as current imports are not overwhelmingly devoted to upgrading the stock of capital and improving long term growth fundamentals. Although Viet Nam has taken steps to address the macroeconomic imbalances, the country's policy stance does not yet decidedly address the fundamental problems of the Vietnamese economy. The latter include, among others: a) the predominance of SOEs in the economy; b) the slow pace of financial sector reform (including banking reform), c) the low efficiency of capital investments, especially infrastructure; and d) the need for greater transparency and disclosure of information that assists improving business confidence. In addition to posing systemic challenges to long-term economic growth prospects, these areas pose significant challenges to the development of the private sector.

12. **Reliance on SME's for economic growth.** Against this backdrop, the government expects that an increasingly larger contribution to economic growth and employment generation will come from the domestic private sector and from SME's in particular. As such, the government has assisted the development of SME's with a combination of landmark policy

³ ADB. 2012. *Viet Nam. Critical Development Constraints*. Ha Noi.

reforms and direct industrial policy assistance. As a result, by end of 2010, there were nearly 550,000 registered enterprises in Viet Nam, up from 14,500 in 2000. SMEs represented 97% of the country's total number of firms, and 46% of GDP. The domestic private sector accounted for 59% of total employment in 2010, up from 29% in 2000. By industry, the wholesale and retail, and vehicle repair sector account for nearly 40% of active enterprises, followed by manufacturing (18%) and construction (16%).

13. The large increase in the number of private sector companies since the approval of the Enterprise Law in 2000 has been followed by sustained increases in the average dimension and productivity of the firms. Between 2000 and 2010, the average capital per firm has increased six-fold, and the average net revenue per employee has tripled. The average SME size remains however quite small at 22 employees per enterprise, and an average capital of VND 17.6 billion (approx. \$900,000).⁴ The contribution of SMEs to tax revenue is increasingly important. By end of 2010, of the 336,000 enterprises paying taxes in Viet Nam, 318,000 were private enterprises, 13,000 were foreign owned enterprises and around 5,000 were state-owned enterprises.

14. **Despite progress, inefficiencies remain.** Despite the reforms undertaken over the last decade, significant inefficiencies remain in the regulatory framework for small and medium enterprises, which places a critical constraint on employment generation. As a result, income-based national poverty reduction goals and strategies have been compromised. A flourishing SME sector will prove instrumental to support the demands for jobs of the estimated 1.7 million young Vietnamese workers joining the labor market annually. The business community has been vocal in requesting an overhaul of the Enterprise Law 2005 that addresses these regulatory inefficiencies. Among them, further clarity it is required on the instances for the application of specialized laws (e.g. Investment Law) versus the Enterprise Law. More importantly, the distinctions between domestic and foreign-owned enterprises need to be eliminated to ensure equal playground for business development. Finally, corporate governance provisions will need to be incorporated into the amended law.

15. **Access to finance.** According to a recent World Bank survey, access to finance is a major constraint for 45% of small firms, a percentage significantly higher than for larger enterprises. Compounding the traditional challenges in obtaining and using collateral, the current regulatory framework limits non-collateral forms of debt financing. Perhaps as a result, a government survey reports that 65% of enterprises in the manufacturing sector depend on retained earnings to finance investment, and only an estimated 5-10% of SMEs obtain credit from banks. In addition, the commercial banking sector favors very conservative practices in collateral valuation and loan tenure, further limiting financing options.

16. **Complexity of administrative processes.** Viet Nam has registered remarkable achievements in streamlining business registration since the implementation of the Enterprise Law in 2000. Unfortunately, progress in the simplification of other administrative procedures for business operations is more uneven. Between 2005 and 2008 alone, Viet Nam issued over 17,000 legal normative issues that affected businesses. An unclear assignment of responsibilities among the different levels of government administration tends to produce overlapping and inconsistent regulations in critical areas such as land use rights, tax compliance and customs administration. As a consequence, competition among economic players has been negatively affected. If entrepreneurs perceive that regulations can be interpreted or applied in

⁴ Ministry of Planning and Investment. 2012. *White Paper on Small and Medium Sized Enterprises in Viet Nam 2011*. Ha Noi.

arbitrary ways, it often affects their willingness to initiate or further invest in the development of ventures.

17. **High tax and compliance costs.** The administrative burden imposed on businesses translates into high tax compliance costs. On average, a company has to spend 941 hours in complying with tax payments (a total of 32 per year), which ranks Viet Nam 138 out of 183 countries in the Doing Business Report 2013. In addition, despite recent improvements, the number of documents required to support imports in Viet Nam is still above regional averages and the cost to import goods has steadily increased.

18. **Limited access to legal services.** Increasingly, SMEs have been highlighting limited access to legal services as an important constraint to their development. The latter has been more prominently identified in the context of land disputes, but also in terms of access to laws and legal advice generally. The government has also identified the amendment of the Competition Law as a key legislative priority, for which it has completed a 5-year enforcement review that will serve as the basis for the draft amendments.

19. **Improving stakeholder dialogue and the statistical base for policy formulation.** The involvement of the private sector and other relevant stakeholders in designing and executing SME policies has been inadequate. Only limited and largely ad hoc procedures allow the involvement of the business community. Lack of stakeholder participation has extended to the evaluation of past policies, the formulation of new strategic plans, and to the improvement of the statistical base for policy formulation, especially with the incorporation of additional gender dimensions.

B. Intended Impact and Outcome of the SMEDP2

20. The impact of the Second SME Development Program is to increase the contribution of SMEs and the private sector in achieving sustainable high economic growth. The program is targeting a doubling of newly registered enterprises, and a 10 percentage point increase in the share of employment of SMEs and the private sector by 2015. In addition, the program aims to prompt: a) improvements in the share of public sector investment (out of gross investment); b) reductions in the per capita cost of starting a business; and c) 5% annual increases in SME and private sector employment. By assisting the development of a consistent regulatory framework, the outcome of the program will be an improved business environment to support more competitive SMEs and the private sector. An expanding SME sector will generate more and higher value-added jobs, and contribute to sustainable poverty reduction.

C. Options for reform

21. In designing the SMEDP2, a number of regulatory and non-regulatory options for reform were considered. The program has been assisting the government of Viet Nam in: a) improving policy and planning framework for SME development; b) improving the development of national business registration systems and simplifying administrative procedures of SMEs; c) providing legal support for businesses and improving the quality of new legal documents; d) simplifying tax and customs policies and administrations procedures; e) improving labor market regulation and market data collection systems; f) improving access to commercial bank lending and to alternative financial services; and g) supporting SME access to debt and equity finance.

22. **Improved strategic planning.** Assistance to the improvement of the policy and planning framework for SME development has been articulated through: a) support to the participatory

formulation of the SME Development Plan 2011–2015; and b) support to the development of improved databases on SME and the regular publication of statistics in order to assist policy formulation.

23. **Regulatory reforms.** Subprogram 2 of the SMEDP has supported two major regulatory initiatives for SME development. First the ongoing process for the review and amendment of the Enterprise Law, for which a first draft is already under discussion. In addition, the SMEDP2 has supported the process of review and amendment of the Law on Competition, for which a 5-year enforcement review has been completed as the basis for the forthcoming draft amendments. Additional regulatory reforms include the support provided to the implementation of Regulatory Impact Assessments to assist law preparation in Viet Nam, including the preparation of new guidelines.

24. **Administrative reforms and new system development.** SMEDP2 has supported the simplification of 4,800 administrative procedures as well as the full implementation of the e.customs system for commercial imports and exports. In addition, SMEDP2 has simplified the tax payment system which has reduced the time required for the release of goods. SMEDP2 also includes efforts to assist tax compliance by reducing the frequency of VAT tax declarations from a monthly to a quarterly basis.

25. **Institutional development and capacity building.** The SMEDP2 has provided support to the government to simplify business regulations through Project 30, including the establishment of the Administrative Procedures Control Agency to ensure efforts to simplify administrative procedures can be sustained. In addition, the government has established a new division within the Ministry of Justice to assist the implementation of Program 585 “Legal Support to SMEs”.

26. **Improved access to credit.** To improve access to credit, SMEDP2 has supported the efforts of the SBV to improve the capacity of commercial banks to provide credit to SMEs. SMEDP2 also supported the amendment of the credit guarantee scheme to ensure a more balanced risk distribution. In addition, the government has provided new and alternative financing options with the preparation of the new Leasing Decree. Finally, a review of UpComm’s operations by the Ha Noi Stock Market was carried out to improve access to equity financing by SMEs.

D. Impact Analysis

27. The impact of a set of reforms such as the ones proposed in SMEDP2 will extend over several years. In our analysis, we necessarily place the focus on the consideration of static costs and benefits. A dynamic examination of the impact of the regulatory changes proposed would require forecasting, with computer generated equilibrium models, the levels of a range of variables over the medium to long term, and then estimating the expected costs and benefits of the set of reforms proposed, based on the evolution of such variables over time. Ultimately, the removal of regulatory barriers to enterprise creation and development would render economy-wide benefits in the form of improved competitiveness of local firms in the domestic and international arena, sustainable job creation, and increased participation of the domestic private sector in Viet Nam’s GDP.

28. This dynamic analysis is however outside the scope of this assessment. Our focus is on the static net gains derived from the reforms proposed. A static impact analysis of the program offers important insights on the expected gains derived from reforms should critical economic

indicators remain at current levels. Even under these somewhat limiting assumptions, the implementation of the package of reforms may usher very sizeable net benefits.

E. Estimate of Costs

29. ADB staff estimates that the direct costs of the subprogram to the public sector could be \$465 million over the program's medium term period of 2011 to 2015, or 0.3% of GDP. The costs would come from the administrative, enforcement and fiscal costs derived from the implementation of the various policy reforms.

30. We classified costs among: 1) administrative costs (or directly derived from the implementation of the program by government agencies); 2) enforcement costs (incurred during the enforcement or regulations and monitoring of compliance); and 3) fiscal costs (associated to required budgetary expenditures, foregone tax revenue, financial costs, etc.).

31. On that basis, an initial estimate of costs would include:

Table 2. Summary of Cost Estimates for Government from the SMEDP2– SP 2

Types of Adjustment Costs	Government and Statutory Agencies	Total (\$ million)
Administrative Costs	1. <u>Legislative initiatives:</u> <ol style="list-style-type: none"> i. Review and amendment of the Enterprise Law. ii. Review and amendment of the Law on Competition, including the preparation of the 5-year enforcement review plan, discussion of several drafts and dissemination of consultations. iii. Cost of reviewing and amending regulation on leasing. iv. Other regulatory developments (revised regulation on Credit Guarantee Scheme, Program 585, etc.) 2. <u>Policy and strategy formulation</u> <ol style="list-style-type: none"> i. Review of the SME Development plan 2006-2010. ii. Formulation and approval of the SME development plan 2011-2015, including consultations with stakeholders and dissemination of the plan. iii. Data Development on SMEs 	Approx. 2.00
Enforcement Costs	<u>Increased supervision and implementation costs:</u> <ol style="list-style-type: none"> i. Augmented supervisory responsibilities of SBV over the local Credit Guarantee Schemes. ii. Align RIA implementation to harmonized guidelines. iii. VCA advocacy activities for Law on Competition. iv. Decree 66/2008 on SME legal services, leasing regulation, etc. 	Approx 3.00
Fiscal Costs	<ol style="list-style-type: none"> 1. Implementation of Medium-Term Plan for Customs Modernization 2011-2015: \$300 million (2011-2015) 2. Implementation of the SME Development Program 2011-2015: \$55 million (2011-2015) 3. Development of the SME Development Fund: \$100 million (annual allocation for 2015) 4. Cost of Implementation of Project 30 and cost of Agency for Administrative Simplification (Fiscal: staff, training, overall 	Approx. 460.00

	budget, future extension of analysis to provincial governments, etc.): approx \$2 million (2012-2015). 5. Estimated budget of the Program of Legal Support to SE, under the Decree 66/2008 including Budget of the division under MoJ: \$1 million (2012-2015)	
Total Estimates	Approx. \$465.00 million	

F. Estimate of Benefits

32. Our analysis estimates that the benefits derived from the implementation of the package of reforms incorporated into the SMEDP2 (SP2) could be in the vicinity of \$900, or approximately 0.6% of GDP.

33. **The SMEDP2 incorporates key regulatory reforms that can assist economic growth via improved economic governance.** Among them, the upcoming amendment of the Competition Law and the Enterprise Law are expected to assist further improvements to the creation of an even playing field for economic enterprise. These reforms will affect growth through higher total factor productivity via improved governance. Total factor productivity explained on average 26% of economic growth in Viet Nam between 2000 and 2009. However, its statistical relationship to governance has not been established in Viet Nam yet, which prevents an accurate estimate of the economic impact of the governance reforms incorporated in the program.

34. **Simplification of administrative procedures.** The ongoing initiation of Project 30 can provide efficiency gains of \$300 million per year in reduced compliance costs to businesses and citizens. The simplification of 4,800 administrative procedures was expected to eliminate \$1.4 billion in compliance costs over a 5 year period. The 3,800 administrative procedures simplified until now represent some 50% of the estimated reduction on compliance costs, or some \$750 million as of September 2012. The remaining savings will be achieved upon simplification of the outstanding 1000 administrative procedures by the Administrative Procedures Control Agency.

35. **Reduction of customs and tax compliance costs.** The full implementation of the e.customs system is reducing compliance costs via the simplification of e.customs declarations and their submission process. Prior to the implementation of the new system, a declaration could take up to 1 day, since it required the submission in person at the department of customs. With the new system, it takes approximately 5 minutes to complete the declaration, which could be also done remotely. In 2012, the administrative costs associated to exporting a container of goods was estimated at some \$580 on average, whereas the cost of importing a container of goods was estimated at \$670.⁵ The flow of container port traffic in Viet Nam is estimated at nearly 6 million (Twenty foot equivalent units or TEUS), of which nearly 3.6 million relates to international journeys (2 million imported containers and 1.6 million exported containers). Assuming, conservatively, that the cost of filing a customs declaration represents solely 2% of the cost of importing or exporting a container, compliance costs would be estimated at \$45 million dollars in 2012 alone, and around \$140 million over the period 2012–2015. The current system has the potential of halving such compliance costs and thus potentially offers \$70 million in savings over the period 2012-2015. Savings will be greater as more companies implement the e.filing software and e.payment systems.

⁵ World Bank. 2012. Doing Business Report: Viet Nam. Washington DC.

36. In addition to improvements to the submission of customs declarations, a new, simplified tax payment system has been implemented under decision 85/2011 that allows for the reduction on the time required for the releases of imported goods from the customs department due to improved information flows between Treasury, Customs and the participating commercial banks. The system has now been implemented in 9 out of 34 customs offices and is expected to save around \$10 million per year upon full implementation.

37. **Reduction in tax compliance costs.** Tax compliance costs for SMEs have been reduced with the decision to limit the frequency of VAT declarations from monthly to quarterly under the amended law on tax administration. It is estimated that compliance with monthly declarations required 336 hours, which can now be reduced to some 120 hours. The reduction of 216 hours is equivalent to 27 person-days. The General tax department has estimated that the reform will save firms some \$30 million per year, or approximately \$90 million over the period 2012–2015.

38. **The revised guidelines for the Credit Guarantee Scheme for SMEs provide more balanced distribution of risks between participating financial institutions and the government.** Currently, the Scheme guarantees credit for an approximated value of \$600 million and it will reasonably increase over the next few years through the local guarantee schemes. The costs associated to the service will likely remain at .5% of the credit amount guaranteed. The Credit Guarantee Scheme for SME is expected to reduce the cost of medium term lending by 1 to 2 percentage points. Overall gains will thus be dependent on the total amount of guarantee credits. Assuming that those are in the vicinity of \$700 within the next 5 years, a conservative estimate, savings due to this reform may amount to \$14 million per year, or nearly \$50 million between 2013 and 2015.

Table 3. Summary of Benefit Estimates from the SMEDP2–SP 2

Policy Output	Amount (\$ million)
1. Simplification of Administrative Procedures for SME operations.	750.00
2. Reduction of Customs Compliance costs:	
a. Implementation of e.filing	70.00
b. Implementation of new payment procedures	10.00
3. Reduction of Tax Compliance costs for VAT	30.00
4. Reduced cost of lending for SMEs through the Credit Guarantee Scheme	40.00
Total	900.00