PCI 2013

THE VIETNAM PROVINCIAL COMPETITIVENESS INDEX 2013

Measuring economic governance for business development

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FOREWORD

The *Provincial Competitiveness Index 2013* is the ninth PCI report on the quality of economic governance across 63 provinces in Vietnam. As the Government of Vietnam reiterates its emphasis on regulatory and institutional reforms, vividly expressed in the Prime Minister's New Year Message, the *Provincial Competitiveness Index 2013* provides objective indicators of the quality of economic governance in areas that are crucial for investment and growth. These indicators shed light on where reforms are needed and provide clear signals about how to improve regulatory quality. The *Provincial Competitiveness Index 2013* is built on the voices of 8,093 domestic non-state enterprises from all 63 provinces. It also covers the opinions of 1,609 foreign-invested enterprises operating in Vietnam, in order to place provincial competitiveness in the broader context of Vietnam as an international investment destination.

The *Provincial Competitiveness Index 2013* is the *first* of a series of Provincial Competitiveness Index reports that is wholly administered by the Vietnam Chamber of Commerce and Industry (VCCI) with support from the U.S. Agency for International Development (USAID). This is a symbol of successful development assistance with lasting effects where a local partner, i.e. VCCI, has evolved to become a fully capable partner to continue bringing the Program to the next level of success.

As set out at the beginning of the Provincial Competitive Index, methodological reviews and adjustments are due every four years. This year, the *Provincial Competitiveness Index 2013* employs some important changes and adjustments in methodology to keep up with changes in the business environment and the regulatory landscape of Vietnam. Specifically, new data are used for constructing sub-indexes while some outdated indicators were dropped. Moreover, a sub-index of "Policy Bias" has been revitalized to reflect businesses' concerns about the presence of a level playing field. These methodological changes do not affect the consistency or the ranking of the *Provincial Competitiveness Index*, which continues to emphasize the governance areas that matter to businesses and those that need reforming.

Per the traditional format, Chapter 1 of the *Provincial Competitiveness Index 2013* provides insights into the latest developments in ten areas of economic governance within the provinces. It also sheds light on confidence levels and perceptions of future business prospects as expressed by Vietnam's private sector. Chapter 2 discusses the views of Foreign Invested Enterprises regarding local governance and includes a special analysis into transfer pricing in an effort to add new empirical data to the current policy debate on this issue in Vietnam. Chapter 3 covers an analysis on the relationship between participation in the law-making process and firms' compliance with law and regulations. The results suggest that higher responsiveness from law-making agencies to the comments of businesses can lead to better legal compliance by firms. This calls for a requirement for law-making agencies to respond publicly and responsibly to firms' comments, in order to not only generate better quality laws and regulations, but also to enhance their effectiveness in implementation.

As with previous PCI reports, we hope that the *Provincial Competitiveness Index 2013* will provide policy-makers and provincial leaders with useful information and recommendations for consideration and action. We also hope that this effort will contribute toward improving Vietnam's regulatory and institutional quality, leading to greater competitiveness and a higher standing in the world economic system. The ultimate goal is to promote greater investment, job creation, and prosperity for all Vietnamese citizens.

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ACKNOWLEDGEMENTS

The Provincial Competitiveness Index (PCI) 2013 is the result of a major, ongoing collaborative effort between the Vietnam Chamber of Commerce and Industry (VCCI) and the U.S. Agency for International Development (USAID).

The PCI was developed under the overall leadership of Vu Tien Loc, Chairman of VCCI and Dau Anh Tuan, General Director of VCCI's Legal Department, PCI Program Director, and benefited from assistance and input provided by Joakim Parker, USAID Vietnam Mission Director, Todd Hamner, Director of Economic Growth and Governance for USAID/Vietnam, as well as Lisa Walker, Laura McKechnie, and Le Thi Thanh Binh of USAID/Vietnam.

Dr. Edmund Malesky, Associate Professor of Political Economy at Duke University, led the development of the PCI's research methodology and authored the presentation of its analytical findings.

Dr. Dang Quang Vinh, the PCI's Lead Economist, was responsible for improving the PCI methodology, index construction, and provided invaluable advice and assistance with the statistical analysis. The PCI report and survey is implemented by the Research team, including Pham Ngoc Thach, Nguyen Ngoc Lan and Le Thanh Ha of VCCI.

Dr. Markus Taussig, Assistant Professor at National University of Singapore Business School, assisted in the authorship of Chapter 3.

The PCI report would not be possible without a high quality and strict process of survey, implemented by 50 students under the management, supervision and coordination of Nguyen Le Ha and Nguyen Hong Vuong (VCCI).

We would like to thank Bui Linh Chi, Do Quang Huy and Duong Huong Ly (VCCI) for their effective assistance and support to the 2013 PCI survey and report.

Special thanks go to our team of experts through whose efforts the methodology of PCI 2013 was developed. The experts included Mdm. Pham Chi Lan, Senior economist; Dr. Le Dang Doanh, Senior economist; Mr. Vu Quoc Tuan, Senior expert; Mr. Tran Huu Huynh, Chairman of VIAC; Mr. Phan Trung Can, Director of Binh Thuan's Center for SMEs Assistance; Mr. Do Hai Ho, Director of Hoa Binh Department of Foreign Affairs; Mr. Vu Xuan Tien, Director of VFAM Consulting; Dr. Vo Hung Dung, Director of VCCI Can Tho; Mr. Nguyen Phuong Lam, Vice Director of VCCI Can Tho; Mr. Nguyen Dien, Vice Director VCCI Da Nang; Mr. Pham Binh An, Director of WTO Center, HCMC; Mr. Nguyen

Van Thoi, Chairman of Thai Nguyen's Business Association of Enterprises; Dr. Nguyen Van Thang, National Economic University; Mr. Nguyen Minh Phong, People's Daily; Mr. Vuong Tinh Mach, HCMC's Institute of Research and Development; Mr. Trinh Viet Hung, Director of Thai Nguyen's PPC Office; Mr. Nguyen Van Hung, Da Nang's Institute of Research and Development; Mr. Le Duy Binh, Director of Economica Vietnam; Mr. Doan Ngoc Minh, Mr. Phan Nhat Thanh, Hai Duong DPI.

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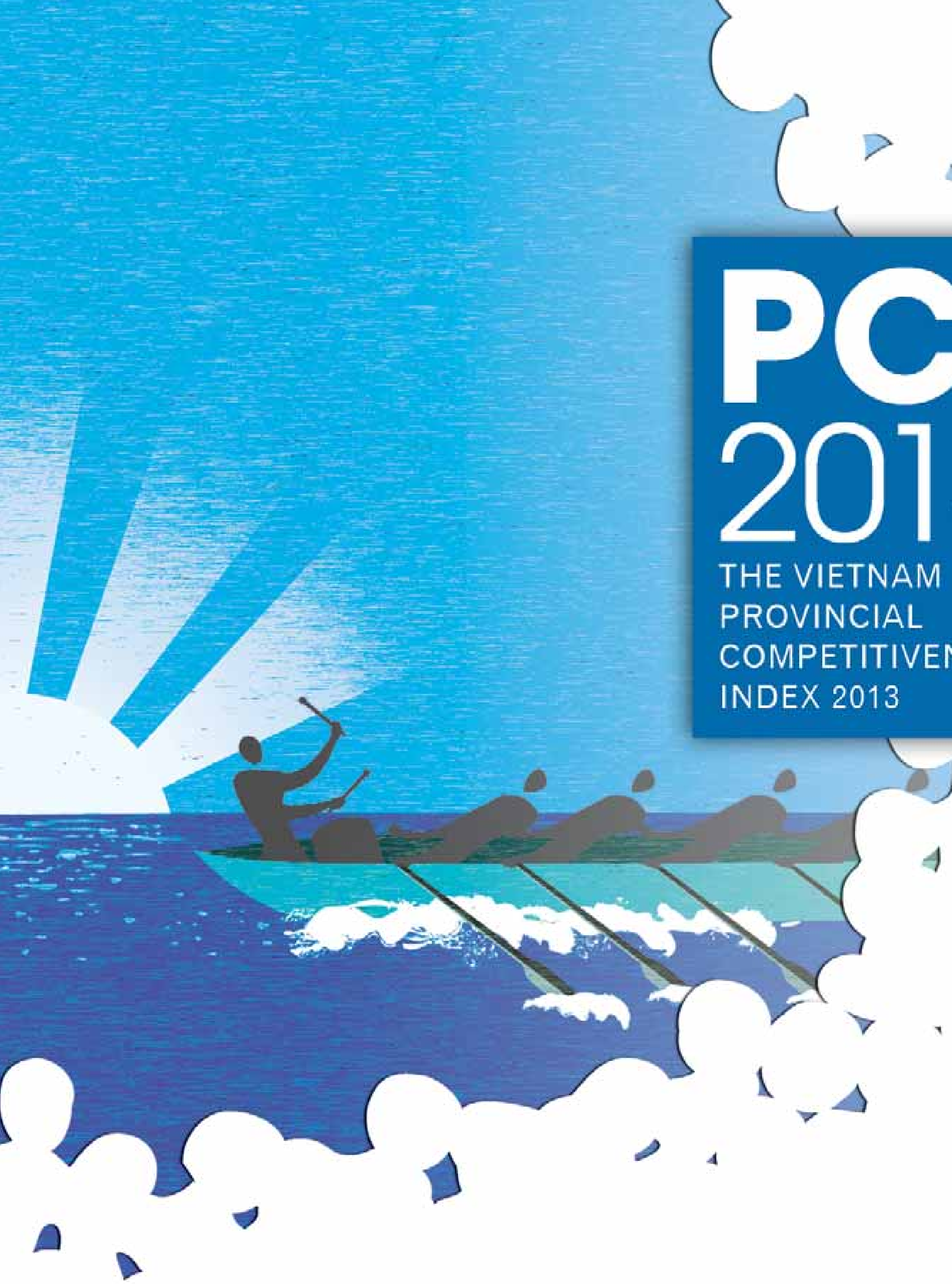
ABBREVIATIONS AND ACRONYMS

ASEAN	The Association of Southeast Asian Nations
BTA	Bilateral Trade Agreement
BSS	Business Support Services
CEO	Chief Executive Officers
DPI	Department of Planning and Investment
EVN	Electricity of Vietnam
FDI	Foreign Direct Investment
FIEs	Foreign Invested Enterprises
FIL	Foreign Investment Law
GDP	Gross Domestic Products
GSO	General Statistics Office
HCMC	Ho Chi Minh City
ICT	Information and Communications Technology
IZs	Industrial Zones
LURC	Land Use Rights Certificate
MOLISA	Ministry of Labor, Invalids and Social Affairs
MONRE	Ministry of Natural Resources and Environment
MPI	Ministry of Planning and Investment
OLS	Ordinary Least Squares
OSS	One-stop Shop
PAR	Public Administration Reform
PCI	Provincial Competitiveness Index
PPC	Provincial People’s Committee
SOEs	State Owned Enterprises
SMEs	Small and medium sized enterprises
USAID	United States Agency for International Development
VCCI	Vietnam Chamber of Commerce and Industry
VNCI	Vietnam Competitiveness Initiative
WTO	World Trade Organization



PCI 2013

THE VIETNAM PROVINCIAL COMPETITIVENESS INDEX 2013

EXECUTIVE SUMMARY

SUMMARY OF CHAPTER 1:

Survey of Domestic Enterprises and the 2013 PCI

- ***The Ninth Provincial Competitiveness Index (PCI):*** The PCI, in order to promote the development of the private sector, is designed to assess the ease of doing business, economic governance, and administrative reform efforts by local governments of provinces and cities in Vietnam. The 2013 PCI is the ninth iteration of the report. The report is based on a rigorous survey of the perceptions of 8,093 domestic firms. In short, the PCI augments the collective voice of private entrepreneurs in Vietnam regarding economic governance in their province and the country.

- ***What Does the PCI Measure?*** The overall PCI comprises ten sub-indices, reflecting economic governance areas that affect private sector development. A province that is considered to perform well on the PCI is one that has: 1) low entry costs for business start-up; 2) easy access to land and security of business premises; 3) a transparent business environment and equitable business information; 4) minimal informal charges; 5) limited time requirements for bureaucratic procedures and inspections; 6) minimal crowding out of private activity from policy biases toward state, foreign, or connected firms; 7) proactive and creative provincial leadership in solving problems for enterprises; 8) developed and high-quality business support services; 9) sound labor training policies; and 10) fair and effective legal procedures for dispute resolution.

Pessimism Still High in 2013

- ***Declining Growth:*** Both foreign and domestic firms showed declining growth rates
  - Only 6.4% of private, domestic firms increased their investment size, and only 6.2% of operations added labor in the past year.
  - 33.4% of foreign firms added employees, but only 5.1% increased their investment sizes, which remain small by international standards (about $1.4 million on average)

- ***Business Confidence:*** Each year, the PCI use the "Thermometer of Business Sentiment" to measure business prospects for the next two years. Optimism of respondents has dipped considerably in recent years, declining from a high of 76% expanders in the year before World Trade Organization entry to historic lows of 33% for domestic businesses and 28% for foreign businesses in 2013.

Methodological Changes in 2013

- ***Research Trade-Offs:*** One challenge that the PCI faces is keeping pace with the dynamism of the Vietnamese economy and changes in the country's regulatory environment. To ensure that the PCI is relevant to current needs of Vietnamese policy makers, the PCI research team committed in 2005 to recalibration of the index every four years. We fulfilled that commitment in 2009 and again in this 2013 iteration of the report.

- ***Revisions:*** 2013 PCI has been altered slightly. Indicators and sub-indices whose utility had become obviated by changes in the Vietnamese economy were dropped, appropriate new indicators were added, and weighting of sub-indices was re-calibrated to reflect the changing importance of different aspects of governance. Four major changes are:

  - *New Index on Policy Bias:* By far this most important change was the improvement upon a sub-index that appears to have been discarded prematurely in 2009 when Local State Owned Enterprises (LSOEs) declined as major players in provincial economies. At that time, we thought that this development spelled the end of policy bias toward SOE by provincial policy-makers. We were wrong. In fact, policy bias continued and even became more severe in the favoring of local branches and subsidiaries of Centrally Managed SOEs (CSOEs). In 2013, 31% of respondents describe bias toward SOEs in the allocation of land, capital, and procurement contracts as a major impediment to their business.

    Focusing on CSOEs alone did not capture the full extent of policy bias by provincial officials. Two other forms of bias have been highlighted by respondents at nearly the same level as SOEs. First, respondents stress favoritism toward former SOEs and connected firms, as 35% of respondents claimed the biggest bias they faced was toward equitized and other connected operations. According to the General Statistical Office (GSO), over 2048 registered private businesses have controlling shares held by the government. Second, 32% of respondents claim that their provincial leaders prioritize attracting foreign investment over helping their businesses. The new index has three dimensions to capture each of these common forms of bias that might crowd out private investment.

- *New Provincial Website Score:* The application of PCI on provincial websites finally caught up with the PCI. In 2005, when the index was developed, provincial websites were quite rudimentary, so very few provinces had basic information, such as provincial budgets, infrastructure maps, and descriptions of investment incentives. Over time, however, provincial websites have been quite sophisticated and the PCI measure became outdated, failing to differentiate true provincial innovators in online openness at the top end of the rankings. This year, the research team updated it, extending our measure to a fifty-point scale. It now ranks provinces based on detailed information about budget access, land policies, labor policy and recruitment possibilities, local investment incentives and regulations, the provincial gazette of local decisions and circulars, and mechanisms to facilitate online business registration and licensing.

- *Upgrading of Sub-Indices:* Finally, we altered the mix of indicators within individual sub-indices—dropping obviated measures, adding new indicators, and, in a very few cases, changing coding in indicators to enhance the comprehension of policy makers. Four sub-indices (Entry Costs, Land, Transparency and Legal Institutions) required substantial improvements.

- *New Sub-Index Weights:* Adding a new sub-index and altering indicators necessitated that the weighting strategy be updated to make sure that PCI continues to relate the most relevant information to provincial officials regarding the impact of their policies on private sector activity. As in the previous indices, weights were calculated using a three-step statistical procedure, where measures of private sector performance are regressed on each of the sub-indices. The weights remain broadly consistent. Transparency and Labor continue to be the most important sub-indices for provincial economic performance. This year, however, Business Support Services (BSS) also joins them in the top tier.

• ***Stability despite Change:*** The methodological changes had very little impact on the overall ranking of provinces. There is a strong statistical correlation (0.72) between the 2013 and 2012 rankings. This is roughly the same as previous years, indicating that the ranking of governance is quite stable, but provinces do have opportunities to make improvements that can raise their scores.

The 2013 Provincial Competitiveness Index (PCI)

• ***Da Nang Again Tops the Rankings:*** This year the central city of Da Nang and Thua Thien Hue (TT-Hue) province stand out even among the excellent tier with new PCI scores above 65. Neither province is a surprise at the top of the index.

- Until 2011, Da Nang had ranked either one or two in every single PCI report.

- TT-Hue also has an excellent history with the PCI. Since 2007, the province has only ranked below the top 25 provinces and "Very Good" tier once. TT-Hue has also legislated the strictest commitment to PCI success observed anywhere in the country. Since 2007, it has issued seven informal documents (i.e. Strategic Plans) and three binding People's Committee Decisions.

• ***Other Excellent Provinces:*** Also represented in the Excellent tier are the perennial success stories of the Mekong Delta: Dong Thap (63.35) and Kien Giang (63.55). In the history of the PCI, Dong Thap has never ranked below eleven, peaking by reaching the top spot in 2012; Kien Giang has slowly climbed up the ranking over time, ranking 6th last year. Quang Ninh (with an average PCI ranking of 18 and top rank of 7 in 2010) and Ben Tre (with an average PCI ranking of 16 and top rank of 7 in 2008) are also no strangers to the top echelon of the PCI. Indeed for years, Ben Tre was consistently the best performing province in the ranking of informal charges. The only surprise at the top of the index is Quang Ngai, which ranks 7th this year. This score is a remarkable improvement for the province, which has an average PCI score between 2006 and 2012 of 38.5 and has never ranked higher than 18th. It appears that Quang Ngai's improvements, like TT-Hue, may result from a provincial commitment to improve its governance that is reflected in local policy documents.

The 2013 PCI Infrastructure Index

• ***Motivation:*** By popular demand, this year reinstates our supplemental Infrastructure Index begun in 2008. Problems with Vietnam's infrastructure are harming its productivity. Although infrastructure quality cannot be attributed directly to provincial officials, increased fiscal decentralization has, in theory, increased the opportunities for provinces to raise their own resources for infrastructure improvements. In addition, both foreign and local domestic investors communicated to VCCI how much they depend upon the infrastructure measure when decisions about expansion within Vietnam.

• ***Method:*** The Infrastructure Index ranks provinces along four dimensions: 1) industrial zone availability and quality; 2) road quality; 3) utility costs and stability; and 4) information and communications technology.

• ***Performance:*** Da Nang, Binh Duong, BRVT, Bac Ninh, and HCMC receive the five highest scores. TT-Hue, Dong Nai, Thai Binh, Quang Ninh, and Hai Duong round out the Top 10; the rural Northwestern Uplands provinces score the worst.

The Core PCI

• ***Motivation:*** Recognizing that changes in the PCI methodology damage longitudinal analysis, impeding the ability of provincial officials to gauge their reform progress with a constant measure of economic governance over time, we have maintained a Core-PCI that tracks changes in PCI progress using a streamlined set of indicators that are available in all iterations of the PCI reports going back to 2006. In 2009, we acknowledged a hesitancy to publish the measure because of fears that it might confuse end-users. This year, we have decided to more explicitly analyze the Core PCI, because the nine-years of panel data present critical information about the current status of Vietnam's economic reform progress.

- ***Findings:***

  - *Good News:* Viewed through the lens of the Core PCI, 2013 shaped up to be a good year. The median province scored 47 on the consistent measure; the highest score recorded since we started keeping data.

  - *Declines in Petty Corruption:* The Informal Charges sub-index, measuring petty corruption, has shown the most consistent improvement over time.

  - *Entry Costs:* Most provinces have invested great effort into facilitating business entry through reforms of business registration offices, reduced licensing requirements, and OSS. As a result, the median province now scores close to a nine on the ten-point index. There is little more that can be done here, and innovation and effort could best be applied elsewhere.

  - *Success Stories:* Land, Transparency, and Business Services have had more erratic trajectories, jumping up and down slightly. Nevertheless, they all appear to be demonstrating upward trends in the past year.

  - *Remaining Work:* More worrying, however, are continuing declines in two other indicators. Firms continue to feel that the playing field is tilted against the private, domestic sector. Particularly problematic has been the belief that firms with former connections to provincial leadership, such as equitized firms and those managed by former officials, are getting favorable access to land, capital, and procurement contracts. Relatedly, firms are documenting that the proactivity of the provincial leaderships and their attitude to the private sector has consistently eroded since its high in 2007.

  - *Gradual Improvements in Most Provinces:* Because the Core PCI uses the exact same indicators and weighting methodology, it has the helpful feature that we can track progress by individual provinces over time. Studying the index, an extremely positive story emerges – 51 out of 63 provinces (81%) have demonstrated positive improvements since 2006 (shown with blue bars in Figure 1.12). While provinces have moved up and down the rankings, there has been a general march toward better economic performance. Change has not been dramatic, even the fastest improvers like Bac Lieu and Tien Giang have averaged less than two points on the Core PCI per year.

Conclusions

- ***Sunlight Ahead:*** The analysis of the Core PCI is a helpful indicator that there appears to be sunlight ahead on the Vietnamese horizon. Business confidence appears to be negative, but confidence is an outcome of changes in governance that improve the business environment. The Core PCI is capturing important changes in informal charges, transparency, and security of business premises that will improve the prospects for investors. Hopefully, this improvement in governance will create new opportunities for investment and optimism in coming years.

SUMMARY AND KEY FINDINGS FROM CHAPTER 2:

The Foreign Investment Survey

- ***The Fourth Annual Survey of Foreign Direct Investors (FDI) in Vietnam.*** The PCI-FDI survey covers a highly representative selection of 1,609 businesses from 49 countries whose operations are located in the 13 most economically developed provinces. While the PCI-FDI survey is not the only survey of foreign investment in Vietnam, it is the largest and most comprehensive.

- ***Growing Pessimism among Foreign-Invested Enterprises (FIEs).*** Business confidence and performance are at the lowest level since the PCI-FDI survey began. Only 28% of FIEs intend to expand their business over the next two years. Firm-level capital and labor growth are also lower than in previous years. On the other hand, sales revenues have held steady and profitability is up.

- ***Overall Competitiveness for Foreign Investment:***

  - *Competitors:* According to the PCI survey, 54% of the FIEs currently in Vietnam considered other countries (most commonly China (11.1%), Thailand (10.6%), and Cambodia (7.7%)) before investing in Vietnam. In 2011 and 2012, the share of FIEs considering other locations was only 32%, so the uptick itself represents an important marker of Vietnam's international standing. Vietnam is no longer the darling of the international community it was between 2007 and 2010, and must now compete against traditional centers for FDI and some new upstarts.

  - *Investment Strategy:* Of investors considering other countries, 69% selected Vietnam over the competition, while 31% invested in Vietnam as part of a multi-country investment strategy.

  - *Advantages:* Asked to compare Vietnam to the other countries considered, FIEs noted that Vietnam fared well on: expropriation risk (64% preferred Vietnam); policy stability (60%); influence of FIEs over policies that affect their business (59%); and reasonably well on the burden of tax rates (52%) relative to competitors.

  - *Disadvantages:* FIEs evaluate Vietnam to be significantly less attractive when it comes to corruption, regulatory burdens, quality of public services (such as education and health care), and the quality and reliability of infrastructure. On infrastructure, investors place Vietnam in roughly the same neighborhood as its neighbors Cambodia and Laos. But surprisingly, Vietnam appears to rank worse than those two when it comes to corruption and the regulatory burden.

- ***Transfer Mispricing:***

  - *Main Result:* We offer a special analysis of transfer mispricing in the country, demonstrating that about 20% of FIEs engage in the practice of shifting profits to lower their tax burdens, and that the activity would be significantly reduced with more predictable and less volatile tax policy legislation and implementation.

- *Policy Implication:* These results provide a clear policy solution for Vietnamese officials. Harmonizing Vietnam's tax policies with international competitors would go a long way toward reducing profit-shifting. Even without drastic changes in the tax rates, however, if policy-makers can ensure firms a predictable tax schedule in the future, so that businesses can adequately estimate their future burden, those business are more likely to restrain form transfer mispricing – keeping vital revenue in the country that can be used to offset the public services and infrastructure that investors cite as Vietnam's most important strategic disadvantages.

- *The Cost of Policy Volatility:* The finding also conforms with FIE's consistent belief that Vietnam is over-regulated relative to its peers. In this case, over-regulated does not mean the total amount of regulations but their instability, especially in tax policies. Part of the problem is that the considerable changes in Vietnamese taxes (especially customs, personal income tax, and end-user fees) pose expensive costs on firms who must develop new strategies for addressing these changes.

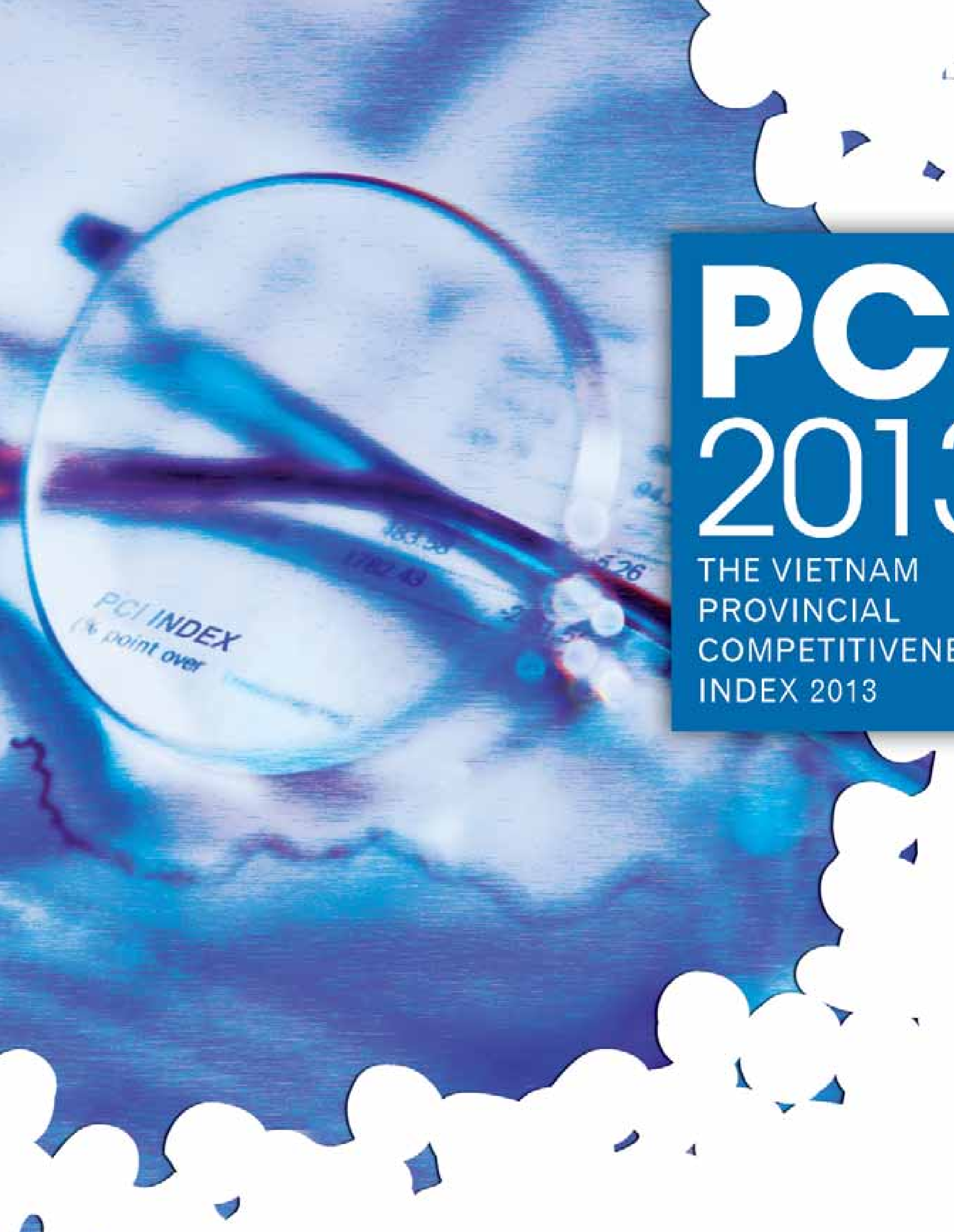
SUMMARY AND KEY FINDINGS FROM CHAPTER 3:

Participation in Legislative Drafting and Regulatory Compliance

- ***Core Finding:*** Using data from the PCI's domestic survey, we find that a firm is more likely to comply with business regulations when it participates in the design of the regulatory framework. Importantly, we find evidence that this only holds when the firm views government as attentive to its input. There is reason to believe that participation may actually be associated with less compliance when government is seen to be disinterested.

- ***Policy Implication:*** This result provides a clear policy recommendation: Ministries in Vietnam should publically release their responses to suggestions by businesses and citizens during public comment periods. Such an action will provide a credible demonstration to businesses that their feedback is taken seriously.

- ***Mechanism:*** Examining the mechanisms behind these findings, we show that a firm's knowledge about its regulatory environment increases with its level of engagement in the drafting of regulations. A firm's attitude about government, however, mirrors our findings on compliance: participation improves perceptions of government effectiveness only when government is seen to be responsive, and actually decreases confidence in policy when this is not the case.



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1 SURVEY OF DOMESTIC ENTERPRISES AND THE 2013 PROVINCIAL COMPETITIVENESS INDEX

Each year, we construct the Provincial Competitiveness Index (PCI) with two goals in mind. First and foremost, we aim to give voice to the opinions, aspirations, frustrations, and experiences of nearly 400,000 private, domestic businesses that operate in Vietnam. Despite their growing numbers and contribution to the economy, this group punches below their weight in policy dialogues. They simply lack the resources and influence of the central state owned enterprises (SOEs) and well-known multi-national corporations (MNCs). Yet, their opinions matter greatly, as these businesses will provide the dynamism, jobs, revenue, and innovation that will carry Vietnam into the next decade. By aggregating the perspectives of the domestic, private sector and presenting them systematically, the PCI hopes to give the entrepreneurial community a greater role in the decision-making process.

> "While the Vietnamese economy is showing some signs of revival, our data shows that private firms continue to struggle."

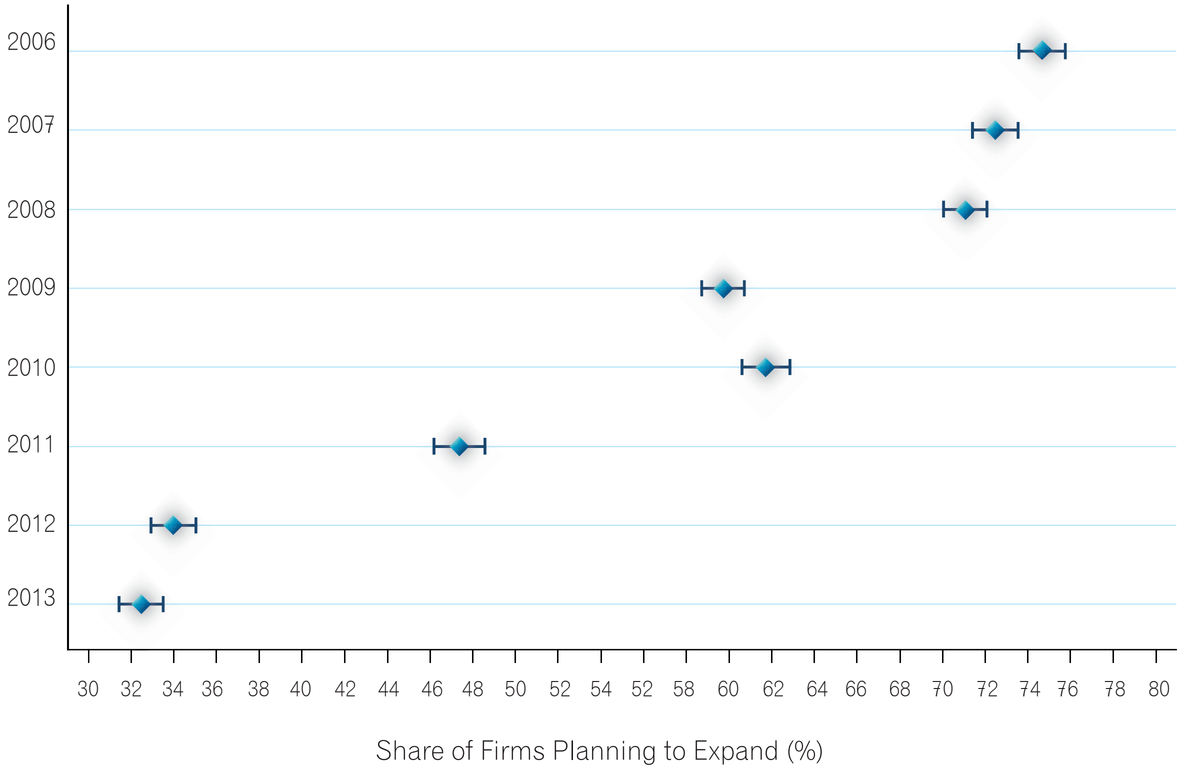
This goal is vitally important in 2013. While the Vietnamese economy is showing some signs of revival, our data shows that private firms continue to struggle. Only 6.4% of firms increased their investment size, and only 6.2% of operations added labor in the past year. As Table 1.1 shows, these numbers are similar to those achieved in 2012, the worst year since the PCI survey was introduced. Moreover, the pessimism is likely to continue. Only 32.5% of respondents plan to expand their operations in the next two years. Figure 1.1 graphically depicts the history of this measure, which we call the *Business Thermometer* because of its accurate diagnosis of business confidence, since 2006. The blue diamonds represent the share of firms who plan to expand, while the range bars depict confidence intervals. It is immediately obvious that business confidence has declined each year since the onset of the PCI.

TABLE 1.1 **Performance of Domestic, Private Firms over Time**

Year	Firms Increasing Investment	Average Investment Size (Billion VND)	Firm Adding Employees	Average Size Employees
2006	27.6%	7.25	22.0%	31.61
2007	27.1%	8.10	20.9%	33.16
2008	29.3%	10.20	21.6%	40.57
2009	15.4%	12.02	12.3%	45.91
2010	22.1%	12.72	17.1%	47.63
2011	14.1%	12.16	11.2%	45.44
2012	6.4%	11.11	6.0%	26.33
2013	6.4%	14.86	6.2%	28.95

Year	Firms Reporting Profits	Firms Reporting Losses	Firms Intending to Expand
2006	77.5%	10.8%	74.6%
2007	81.1%	9.3%	72.5%
2008	82.3%	8.7%	71.0%
2009	69.2%	19.9%	59.7%
2010	74.9%	16.0%	61.7%
2011	72.9%	14.4%	47.4%
2012	58.9%	21.9%	34.0%
2013	64.3%	20.8%	32.5%

FIGURE 1.1 **PCI Business Thermometer over Time**



95% confidence intervals

Secondly, we attempt to address the country's major policy debates by supplying interlocutors with objective and scientific data that we analyze with cutting-edge research techniques. A charged and vivid discussion about the future of the Vietnamese economy is currently taking place in the query sessions of the Vietnamese National Assembly, in the increasingly vocal Vietnamese blogosphere, in the probing Vietnamese media, in the halls of academia and think tanks, and in lively Vietnamese coffee shops. We hope that PCI data can inform these debates, helping policy-makers to make the best decisions possible, and to communicate their choices to the Vietnamese public.

The 2013 PCI continues our efforts to achieve these goals. In the pages that follow, we present the opinions and experiences of 8,093 firms that mirror the population of private, domestic businesses in Vietnam 63 provinces on the key factors that affect business success. We show how these perspectives have changed over time, highlighting key achievements as well as the challenges that still remain. The overall PCI comprises ten sub-indices, reflecting economic governance areas that affect private sector development. A province that is considered to perform well on the PCI is one that has: 1) low entry costs for business start-up; 2) easy access to land and security of business premises; 3) a transparent business environment and equitable business information; 4) minimal informal charges; 5) limited time requirements for bureaucratic procedures and inspections;

6) minimal crowding out of private activity from policy biases toward state, foreign, or connected firms; 7) proactive and creative provincial leadership in solving problems for enterprises; 8) developed and high-quality business support services; 9) sound labor training policies; and 10) fair and effective legal procedures for dispute resolution.

Chapter 1 is divided into three sections. The first section describes the changes in the PCI methodology. Each year, a key dilemma faced by the research team is how to address the unique trade-off posed by a dynamic emerging market like Vietnam. On the one hand, we want an index that keeps pace with the Vietnamese reform agenda, developing indicators that match the growing sophistication and internationalization of the Vietnamese economy. On the other hand, we want an index that is consistent over time, allowing researchers and policy-makers to accurately measure change, and test the relationship between those changes and national, provincial, and business performance. When we originally designed the first PCI almost a decade ago, we agreed that we would resolve this dilemma by both updating the PCI at four-year intervals, and maintaining a set of core indicators that remained consistent over time.

Since the last re-calibration of the PCI occurred in 2009 (four years after the 2005 index), the project was due for a tune-up this year. In Section 1, we describe the key alterations and why we made them, as the story of the changes provides a unique chronicle of how the Vietnamese economy is evolving – for better and for worse. The second section presents the result of the 2013, displaying the graphics that have become well-known by Vietnamese businesses and policy-makers. The third section discusses the PCI Infrastructure Index, which is back by popular demand, after our stakeholders notified us that it played an important role in their locational decisions. The final section analyzes the Core PCI, showing developments over time.

Before jumping into the numbers, we would like to acknowledge an important development in administration of the PCI. Since the onset of the index, the PCI has been a joint venture between the Vietnamese Chamber of Commerce and Industry (VCCI) and the Vietnam Competitiveness Initiative (VNCI) program, which was supported by funding from the United State Agency for International Development (USAID). The PCI was a team effort in every way. It would not have been possible without the helpful international expertise or the local contextual knowledge and understanding of Vietnamese private firms that VCCI delivered.

In 2013, however, the PCI fulfilled the ultimate goal of every development assistance project. The international collaborators were successful enough to put themselves out of business. Each year more and more responsibilities of the research endeavor were shifted to the management of VCCI. As VCCI's capacity grew, it gradually took over the management of the survey design, data collection, quality control procedures, index creation, dissemination, and advocacy roles. This year, as part of the *USAID Forward Initiative*, the inevitable step was taken to transfer the PCI responsibilities entirely to VCCI's hands. We are honored by USAID's to entrust VCCI with this important task and responsibility. VCCI has embraced the opportunity, investing heavily in new resources to maintain the quality and build upon the foundation created by the previous partnership. The PCI has been officially localized, and we hope it will now play an even greater role in the Vietnamese policy-making process.

1.1 METHODOLOGICAL CHANGES IN THE PCI

> "The PCI was designed with the explicit intention of providing actionable policy advice to provincial officials; it therefore provides very detailed and explicit measures.."

Since the original PCI report in 2005, we have repeatedly emphasized that the indicators, sub-indices, and weighting of the index would eventually need to change to reflect reforms and new challenges in the Vietnamese economy. Unlike well-known indices of economic governance—such as the ***Global Competitiveness Index*** or World Bank's ***Governance Indices***—that operate at some level of abstraction, the PCI was designed with the explicit intention of providing actionable policy advice to provincial officials; it therefore provides very detailed and explicit measures. For instance, one-stop-shop (OSS) business registration existed only as isolated provincial experiments in 2005, and full OSS did not become nationwide policy until 2008.[1] Thus, only in the past few years, has the PCI had a large enough sample of OSS users to ask questions specifically about their experiences with the process.

From the outset, we expected that a recalibration would be necessary every four years to catch the index up with changes in the Vietnamese economy. Recalibrating the index also gave us the opportunity to improve the tool based on advice from our stakeholders. Each year, the PCI research team visits dozens of provinces to present specific PCI results to provincial leaders and engage in dialogue about the reform challenges faced by officials on the frontline of policy implementation. These conversations have offered insights into misunderstandings about particular PCI indicators. We have also benefitted from the diligent advice of our advisory board of top Vietnamese researchers, policy advocates, and business leaders, who critique the index and offer insights based on their expertise and experiences. Our board consists of some of the most knowledgeable policy-makers, researchers, and entrepreneurs in Vietnam. They have their finger on the pulse of their economy, and they provided us with precise directions on how the index needed to be altered to keep abreast of the new policy dilemmas facing Vietnam.

Because this is the 4th iteration of the PCI since the last re-calibration in 2009, we decided it was time to implement these broad changes. Changes fell into four categories: A) The addition of the

1 This occurred when inter-ministerial Circular 05 dropped the chop carving permit for business registration, so that only two procedures were necessary: Business Registration and Tax Code issuance, which were to be unified under one number. Prime Minister's Decision No. 236 in 2006 made OSS a Provincial Responsibility, but responsibility for the policy was not certain until inter-ministerial circular (02/2007/BKH-BTC-BCA) put the Department of Planning Investment in charge.

Policy Bias Index; B) The updating of the Transparency Website Score; C) Additions, subtractions, and upgrading of individual indicators within sub-indices; and D) Re-Calibration of weights to take into account the changes in the Vietnamese economy.

A. A New Sub-Index Measuring Policy Bias toward SOEs, FIEs, and Connected Firms

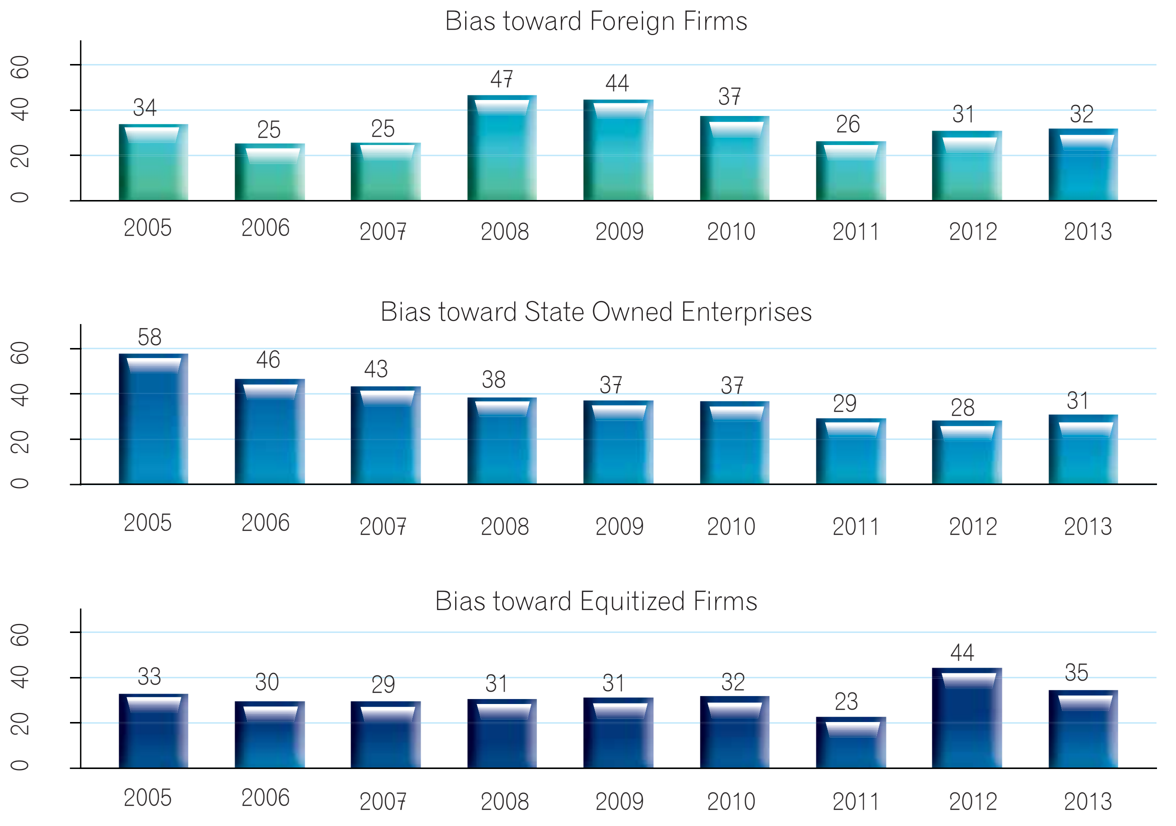
First and most importantly, we resurrected and improved upon a sub-index that appears to have been discarded prematurely in 2009. At that time, our conversations with provincial officials and businesses had led us to believe that policy bias toward the locally-managed SOEs (LSOEs) was no longer a threat to private business. Most LSOEs had been equitized, dissolved, or merged into larger centrally-managed conglomerates. What remained were predominantly public utilities that did not operate in the same industries as private companies, and were not competing with PCI respondents for land, labor, or capital. It seemed clear at the time that LSOEs were no longer relevant to the competitiveness of private companies in the provinces.[2] We stand by that conclusion.

At the time, we were aware of the Vietnamese government's ambition to create large, national champions by merging together smaller SOEs into larger conglomerates, and we knew that branches of the CSOEs would continue to operate at the provincial level. Nevertheless, we chose not to re-focus the sub-index on CSOEs for two reasons. First, we expected that provincial leaders would have very little say in the management decisions of the CSOEs, and therefore would not be motivated to bias policy in their favor. Second, most of our respondents did not operate in the industries covered by the CSOEs, so we didn't anticipate that CSOEs would crowd out the productive private sector companies. Our advisory board and the general consensus among academics studying Vietnam is that we were incorrect on both counts.[3] In fact, some experts have even claimed that dropping of the SOE bias index kept researchers from truly analyzing the implications of the government's conglomerate strategy.

As we noted in the report last year, a common explanation for both poor business performance and declining perceptions of economic governance is policy bias toward SOEs is in fact reducing opportunities for private operations. According to this theory, CSOEs use their monopoly position in protected industries to generate cash flow that allows them to form subsidiary businesses that compete directly against the private sector in industries ranging from real estate to light manufacturing to hospitality. This hypothesis has been articulated in a number of important outlets, and received a great deal of currency from the struggles of state conglomerates, such as Vinashin and Vinalines. In fact, about one third of respondents continue to cite bias toward CSOEs as an obstacle to their business, and that figure has actually increased slightly since 2012. Figure 1.2 graphically depicts these views.

[2] See the 2009 PCI Report (Malesky, E. 2009, Chapter 43, p 48-51) for a thorough discussion of this decision.
[3] Pincus, J. et al. 2012.

Figure 1.2 **Bias toward State, Foreign, and Equitized Firms**



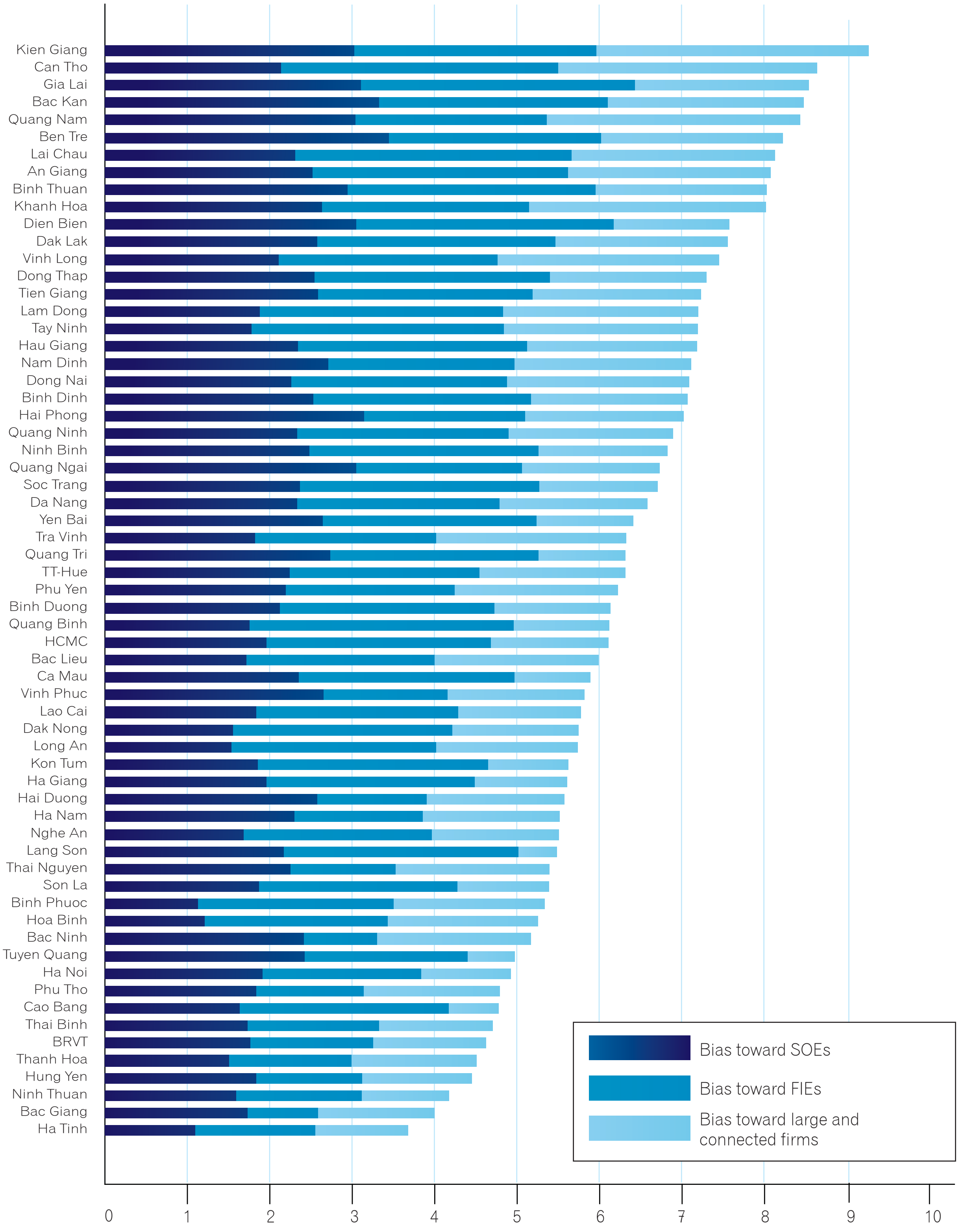
The bias is highest in public procurement (35% agree), but is also visible in land access (27%), credit access (27%), and ease of administrative procedures (26%). The share of firms citing bias is down significantly from the 2005 when we first began asking the question, but it is large enough to remain a concern. Moreover, the level of policy bias varies dramatically across the country. In some provinces, over half the respondents agree that provincial officials favor SOEs in land and credit access. With this in mind, we resurrected the Policy Bias index.

After some careful thought and research, however, we decided that focusing on CSOEs alone did not capture the full extent of policy bias by provincial officials. Figure 1.2 clearly demonstrates why. Two other forms of bias have been highlighted by respondents at nearly the same level as SOEs. These are bias: 1) toward former SOEs and connected firms; and 2) toward foreign firms. As we noted in last year's report, 41% of PCI respondents (35% this year) claimed the biggest bias they faced was toward former SOEs, which have been equitized. These companies, in which the state sometimes retains shares, have unusual connections to policy-makers. According to the latest GSO Enterprise Survey, the government has controlling shares in 2048 registered, private companies across the country. Often their managers are former officials and SOE managers and they maintain close, personal relations with decision makers, benefitting them in competition for resources, procurement, and the attention of local officials. Beyond connections, 35% of firms argued that a province's largest firms (by revenue and labor) were given preferential treatment in interactions with officials.

There is also a healthy belief among respondents that some provincial leaders cater to the needs of foreign investors at the expense of their homegrown entrepreneurs. Overall, about 32% of firms hold that view, down from 45% in 2008. Nevertheless, in some provinces the perception is considerable, especially Tuyen Quang (49%), Nam Dinh (46%), and Ha Nam (44%). Ha Noi, BRVT, and Hai Phong all have over 40% respondents complaining about bias toward foreigners. Although some firms cite land and administrative biases, the biggest problem is simply that local leaders devote too much time to FDI attraction and not enough to resolving the specific problems faced by private firms.

To capture these perceptions in the new PCI, we created a new index called Policy Bias, which has three dimensions: 1) Bias toward CSOEs; 2) Bias toward Foreign Invested Enterprises (FIEs); and 3) Bias toward large and connected firms. The index captures the fine-grained policies that tilt the playing field against the domestic, private sector. A full accounting of the new indicators can be found in the table of indicators and aggregate scores in the annex of this report. Figure 1.3 depicts provincial scores on the new sub-index, showing that the Mekong Delta provinces of Kien Giang and Can Tho provide the most balanced playing field, while private firms in Ha Tinh must battle against considerable difficulties.

Figure 1.3 | **The New PCI Policy Bias Index**



B. Updated Website Transparency Score

The information revolution finally caught up with the PCI. Since the onset, the PCI has used a simple twenty-point measure of provincial documents to gauge the level of business information that was put on provincial websites. In 2005, when the index was developed, the few provincial websites that existed were quite rudimentary, so very few provinces had basic information, such as budget data, infrastructure maps, and descriptions of investment incentives. Over time, however, provincial websites have been quite sophisticated and the PCI measure quickly became outdated, failing to differentiate true provincial innovators in online openness at the top end of the rankings. In 2013, the research team took a hard look at the website information and updated it, extending our measure to a fifty-point scale. It now ranks provinces based on detailed information about budget access, land policies, labor policy and recruitment possibilities, local investment incentives and regulations, the provincial gazette of local decisions and circulars, and mechanisms to facilitate online business registration and licensing. In addition, the new index rewards procedures for online participation, such as online comment forums for regulations and other provincial initiatives. These participatory methods are studied in more detail in Chapter 3. Interestingly, even with the fundamental upgrade of the website score, there is still a relatively strong correlation with the older simplistic approach ($r=0.57$), which is significant at the .05 level.

C. Updated Indices

Finally, we altered the mix of indicators within individual sub-indices—dropping obviated measures, adding new indicators, and, in a very few cases, changing coding in indicators to enhance the comprehension of policy makers. To this end, minor changes were made in almost every sub-index. Four sub-indices (Entry Costs, Land, Transparency and Legal Institutions) required important changes.

Entry Costs: Two indicators measuring the amount of additional licenses, beyond registration certificates, were dropped for two reasons. First, far fewer new firms registered this year, compared to previous years, due to the ongoing economic difficulties. The slowdown is reflected in the PCI sample, which includes only 277 operations which registered after January 1, 2012, compared to 838 that registered in 2011 and 934 that registered in 2010. In most provinces, we had only a handful of new firms with which to work, and in some provinces there were no new registrations at all. The small sample sizes recorded this year make it difficult to confidently estimate the true amount of documents required. We simply cannot rule out the potential that a large number of documents may result from the firm's industrial sector and do not result from a province's registration procedures. To be on the safe side, we dropped these measures.

We replaced those measures with a new indicator measuring the share of firms in provinces that used OSS to complete their registration procedures, which theoretically reduces the time and transaction costs necessary to begin operations. Since OSS became national policy in 2008, implementation has varied across the country. According to PCI data, only 42% of firms used the facility in the minimum-scoring province (Tien Giang), compared to 86% in the maximum province (Thanh Hoa). Usage does not fully capture quality, so we added a battery of indicators that capture a firm's experience with the procedure, including: clarity of information and instructions, professionalism and knowledge of staff, and use of information technology to augment the service. More detail on these indicators can be found in Table 1.2 below.

TABLE 1.2 **New Indicators in Entry Costs Sub-Index in 2013**

Indicator	Source (2013 Survey)	Measure	2013
Percentage of firms registering or re-registering through one-stop-shop.	PCI Survey Question: C3	Min Median Max	41.58 63.41 85.71
Procedures at one-stop-shop are transparently listed (% Agree)	PCI Survey Question: C3.1.1	Min Median Max	21.43 39.02 66.20
Guidance and instruction on procedures at one-stop-shop are clear and adequate (% Agree)	PCI Survey Question: C3.1.2	Min Median Max	26.67 41.14 66.90
Staff at one-stop-shop are professional and knowledgable (% Agree)	PCI Survey Question: C3.1.3	Min Median Max	10.61 25.52 56.38
Staff at one-stop-shop are friendly (% Agree)	PCI Survey Question: C3.1.4	Min Median Max	10.61 24.71 56.38
Information Technology application at one-stop-shop is good (% Agree)	PCI Survey Question: C3.1.5	Min Median Max	3.91 16.07 44.68
None of the statements above are true (% Agree)	PCI Survey Question: C3.1.6	Min Median Max	0.00 1.70 8.94

Land: Our historical measures of land policy in Vietnam were primarily focused on access and security of tenure. The critical concern has always been whether expropriation risk was low enough that firms would be willing to invest and expand. While useful, these measures were too high altitude to appropriately measure more banal frustrations that entrepreneurs were having with the cadastral service. This year we added two indicators that simply asked firms that had recently purchased land, about their experiences applying for Land Use Rights Certificates (LURCs) for those plots. The first indicator is the share of firms that claimed they experienced “no difficulties” in fulfilling land related procedures. This figure ranges from 22% in the worst performing province (BRVT) to 73% in the best (Dak Lak) and 69% in Da Nang, A follow-up indicator adds the share of firms that would like to acquire LURCs for their business premises, but still don’t have them, because of difficulties with land administration procedures. This figure ranges from only 3% in Binh Duong, where firms are extremely satisfied to 50% of respondents in Soc Trang that still don’t have adequate legal protection for their property because of administrative difficulties.

TABLE 1.3 **New Indicators in the Land Access and Security Sub-Index in 2013**

Indicator	Source (2013 Survey)	Measure	2013
Percentage of firms that have completed land procedures in the last two years and have encountered no difficulties in land-related procedures.	PCI Survey Question: B6.1	Min Median Max	21.74% 44.44% 73.33%
Percentage of firms that want to have LURCs but don't have LURCs because of complicated procedures and troublesome staff.	PCI Survey Question: B4.5	Min Median Max	3.03 16.13 50.00

Transparency: In addition to the new website score, new indicators were added to assess whether firms were actually taking advantage of online transparency initiatives. As we traveled across provinces, one issue that repeatedly came up was that provinces had invested heavily in their websites only to find that firms did not know about the changes, and continued to want for critical business information. To address this communication gap, we have consistently recommended to provincial leaders that website upgrades needed to be accompanied with extensive marketing and teaching campaigns to inform businesses about the improvements in e-governance. In addition, we have also suggested that provinces also do more to enable online access for businesses with less computer literacy by providing dedicated terminals at provincial departments and post-offices. This year, three indicators were added to measure the extent of those campaigns. Most directly, we used the percentage of firms that accessed provincial websites. Access is too general, however, to really judge whether information was communicated through the website, so we followed up by asking whether businesses were able to access a provincial budget that has been published, and if so, whether that budget contained enough information to assist their forecasting and business plans. We focused specifically on the budget, because of its utility for all firms and the vital role that budget transparency plays in limiting potential malfeasance.

TABLE 1.4 New Indicators in the Transparency Sub-Index in 2013

Indicator	Source (2013 Survey)	Measure	2013
Openness and quality of provincial webpage	Analysis by PCI Research Team	Min Median Max Correlation w/ Previous Year	11.50 25.50 38.00 0.57*
Percentage of firms that have accessed provincial websites (%)	PCI Survey 2013 Question: F5	Min Median Max	21.43 50.99 70.00
Budget documents have enough details for use in business activities (% Yes)	PCI Survey 2013 Question: F2.2	Min Median Max	35.71 76.92 100
Budget documents are published right after being approved (% Yes)	PCI Survey 2013 Question: F2.2	Min Median Max	27.27 66.67 100

Legal Institutions: This index was subjected to the greatest upgrade of all, because of a similar problem to the Entry Costs index – so few firms were using provincial courts to resolve disputes with business partners that we could not accurately measure aggregate experience with the system. As a result, the index was highly volatile from year to year, because it reacted to the tiny handful of firms that used court procedures in a province that year. If one firm had a negative experience, the entire provincial score was affected. The problem was magnified by a series of filters in the PCI survey, so that only a firm that actually had been in court was allowed to comment on perceptions of fairness and efficiency of the court system. In some cases, one or two aggrieved firms were acting as the spokespeople for an entire province's judicial system. To avoid this volatility, we re-designed the survey to capture general perceptions of the fairness and effectiveness of the court system.

Rather than relying on the minimal sample of firms that used courts, we turned the question on its head, asking the large sample of firms that had business disputes but did not use courts why they avoided the formal judicial system. Thinking about legal institutions this way provides a much more accurate sense how the vast majority of firms view the institutions that protect their property and validate the security of their contracts. Of course, perception bias is still a threat in this index. Those who have never used courts may have more positive views than those who have more intimate knowledge. Nevertheless, we believe that firms talk to each other, so that confidence in the courts is predominantly affected by the experiences of similarly situated firms which actually used the courts.

Moreover, it is important to understand why firms do not use courts to resolve disputes, as this severely limits the scope of partners with whom they can do business. If all contract disputes must be mediated by local notables or social connections, it limits the ability to do business with better partners in other towns or provinces.

These four sub-indices received the greatest attention in the re-calibration of the PCI methodology. Nevertheless, small changes in question wording and indicator selection were made throughout the indexes. End-users should visit our website for a complete understanding of how the assessment tool has changed.

TABLE 1.5 New Indicators in the Legal Sub-Index in 2013

Indicator	Source	Measure	2013
Provincial court judge economic cases by the law (% Agree)	PCI Survey Question: G3.1	Min Median Max	78.13% 89.29% 98.84%
Provincial court resolve economic cases quickly (% Agree)	PCI Survey Question: G3.2	Min Median Max	29.47% 58.00% 80.65%
Court judgements are enforced quickly (% Agree)	PCI Survey Question: G3.3	Min Median Max	38.64% 60.00% 86.02%
Legal aid agencies support business in the use of laws when disputes arise (% Agree)	PCI Survey Question: G3.4	Min Median Max	40.00% 68.75% 86.67%
Formal and informal costs are acceptable (% Agree)	PCI Survey Question: G3.5	Min Median Max	57.35% 77.78% 93.26%
Judgement by the court is fair (% Agree)	PCI Survey Question: G3.6	Min Median Max	71.67% 85.96% 96.70%
Willingness to use court in case a dispute arises (% Yes)	PCI Survey Question: G4	Min Median Max	29.31% 59.74% 77.87%

CHANGES IN PCI METHODOLOGY 2005-2013

2005

SUB-INDEX	WEIGHTS
Entry Cost	17.1%
Land access	8.4%
Transparency	16.1%
Time costs	9.6%
Informal charges	7.6%
Proactivity	16.8%
Private sector development	11.1%
State Owned Enterprise bias	13.1%
Implementation of central policies	0.2%
Surveyed provinces	42/64

2006

SUB-INDEX	WEIGHTS
Entry Cost	5%
Land access	5%
Transparency	15%
Time costs	10%
Informal charges	5%
Proactivity	15%
Private sector development	15%
Statewned Enterprise bias	5%
~~Implementation of central policies~~	~~0.2%~~
Labor training	15%
Legal institutions	10%
Surveyed provinces	64/64

2009

SUB-INDEX	WEIGHTS
Entry Cost	10%
Land access	5%
Transparency	20%
Time costs	15%
Informal charges	10%
Proactivity	10%
Business support services	5%
~~State Owned Enterprise bias~~	~~5%~~
Labor training	20%
Legal institutions	5%
Surveyed provinces	63/63

2013

SUB-INDEX	WEIGHTS
Entry Cost	5%
Land access	5%
Transparency	20%
Time costs	5%
Informal charges	10%
Proactivity	5%
Business support services	20%
Policy Bias	5%
Labor training	20%
Legal institutions	5%
Surveyed provinces	63/63

D. Weights

Adding a new sub-index and altering indicators necessitated that the weighting strategy be updated to make sure that PCI continues to relate the most relevant information to provincial officials regarding the impact of their policies on private sector activity. The final PCI ranking represents the weighted sum of the scores of the ten sub-indices, based on the weights shown in Table 1.6. These weights were re-calibrated in 2013. As in the previous indices, weights were calculated using a three-step statistical procedure where measures of private sector performance are regressed on each of the sub-indices. Sub-indices that were shown to have the largest association with private sector growth, investment, and profitability received the highest weight class of 20%. Correspondingly, those that are not strongly correlated with private sector development outcomes received the lowest weight class of 5%. The medium weight classes of 10% was reserved for average correlations across the three outcome variables, or a large substantive effect on one outcome (e.g., profitability), but a minimal relationship with the other two.[4]

The weights remain broadly consistent. Transparency and Labor continue to be the most important sub-indices for provincial economic performance. This year, however, Business Support Services (BSS) also joins them in the top tier. The Informal Charges sub-index remains a mid-ranked measure, but all the other sub-indices are now only weakly correlated with our three dependent variables. One particularly interesting fall is the role of Proactivity of the Provincial Leadership, which was among the highest ranked sub-indices between 2005 and 2008, dropped to a medium rank in 2009, and now has only a minimal correlation with private sector performance.

[4] Once again, we selected three outcome variables that are critically important for monitoring private sector development (private enterprises per 1,000 citizens, investment per capita, and profit per enterprise). We regressed these on each sub-index, controlling for structural factors (population density, surface area, distance from Ha Noi or HCMC in kilometers), infrastructure (measured by the percentage of paved road in the province), and dummy (dichotomous) variables for the seven regions of Vietnam. Using regional dummy variables enables us to hold cultural, socioeconomic, and structural factors that are region-specific constant, so we can focus just on the differences in governance among provinces. In essence, we are able to remove the variance in private sector outcomes accounted for by the unique difficulties faced by provinces in Northwest Vietnam and Mekong Delta, as well as the special advantages of provinces in the North Southeast. This allows us to isolate the size of the relationship we care about most—the direct association between each sub-index of governance quality and our outcome variables. The t-values from these regressions were taken for each sub-index. Using the size of the t-value is an intuitive approach as it includes the size of the substantive effect (measured by the regression coefficient) but standardized by the variance around that point prediction (as measured by the standard error). As a result, sub-indices that receive higher weights are those that have large and statistically significant correlations with the three outcome variables.

TABLE 1.6 Sub-Index Weightings Over Time

Sub-Index		2005-2008	2009-2012	2013
1	Entry	5%	10%	5%
2	Land	5%	5%	5%
3	Transparency	15%	20%	20%
4	Time	10%	15%	5%
5	Informal Charges	5%	10%	10%
6	Policy Bias	5%	.	5%
7	Proactivity	15%	10%	5%
8	Business Support Services	15%	5%	20%
9	Labor	15%	20%	20%
10	Legal	10%	5%	5%
Total		**100%**	**100%**	**100%**

1.2 THE 2013 PROVINCIAL COMPETITIVENESS INDEX

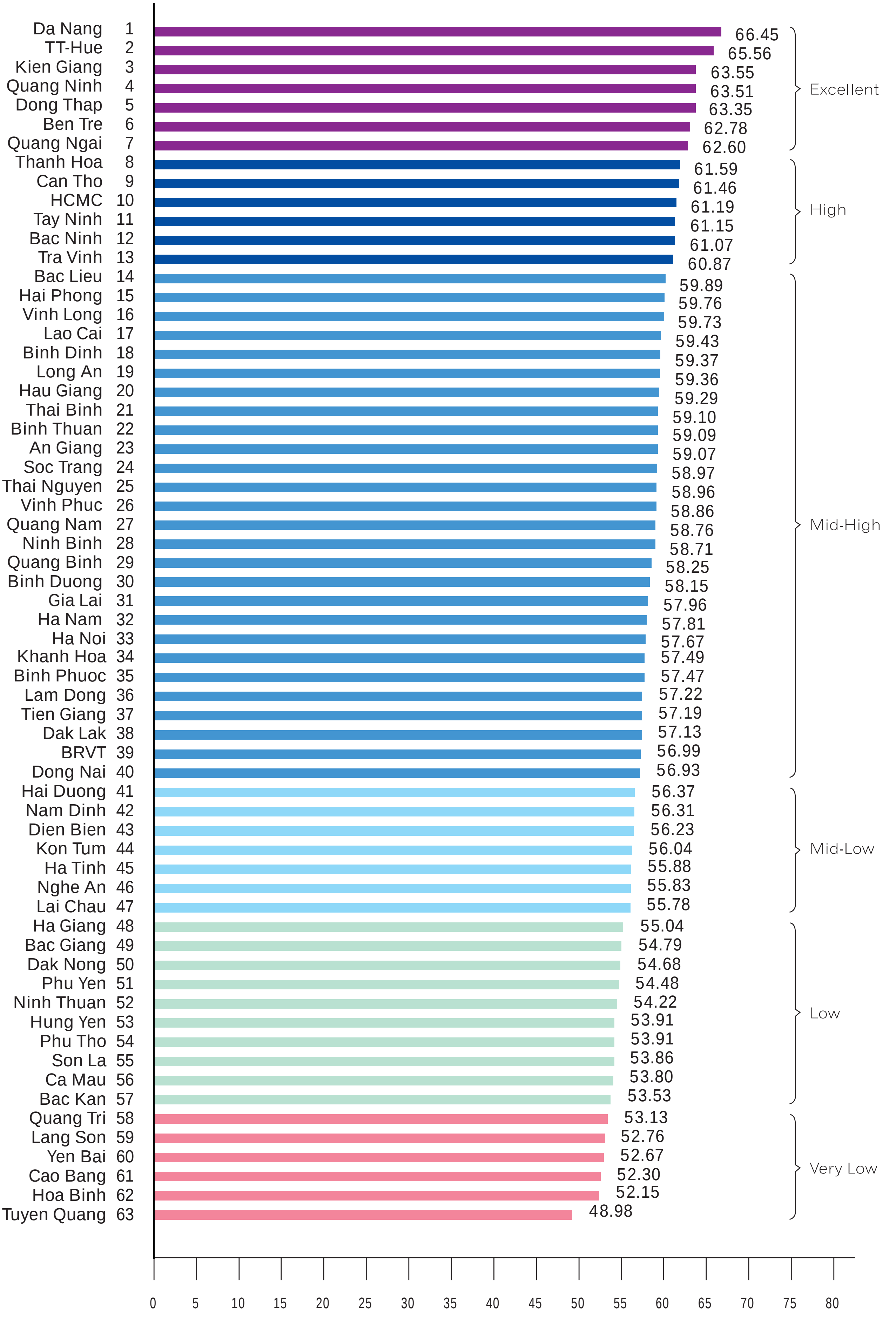
Figure 1.4 presents the updated, composite PCI ranking. Frequent readers of the PCI report should be aware that cut-points for the performance tiers were updated this year to reflect the addition of the new sub-index, changes in indicators, and the re-calibration of weights. To be designated as Excellent, a province needs to reach a score of 62 on the re-calibrated index. In addition, the 4th performance tier, marked in green, has been re-named from "Average" to "Mid Low."

Stability in Rankings Over Time

The change in the ranking methodology cited above had a systematic impact across the country. No region or particular group of provinces was affected disproportionately. As a result, the 2013 rankings look remarkably similar to those from previous years. Da Nang, Dong Thap, and Kien Giang remain among the very best performers in the country. Furthermore, the bivariate correlation between 2012 and 2013 final scores is 0.72 and is significant at the .05 level (see Figure 1.5).[5] By way of comparison, the bivariate correlation between the 2012 and 2011 indices, when no changes in methodology took place at all was 0.73. In short, the PCI remains remarkably stable, able to record improvements for individual provinces, but providing a consistent measure of how businesses perceive governance in their localities.

5 We use the term bivariate to indicate that the result is simply the correlation coefficient, rather than the partial correlation resulting from multiple regression analysis.

Figure 1.4 **2013 Provincial Competitiveness Index**



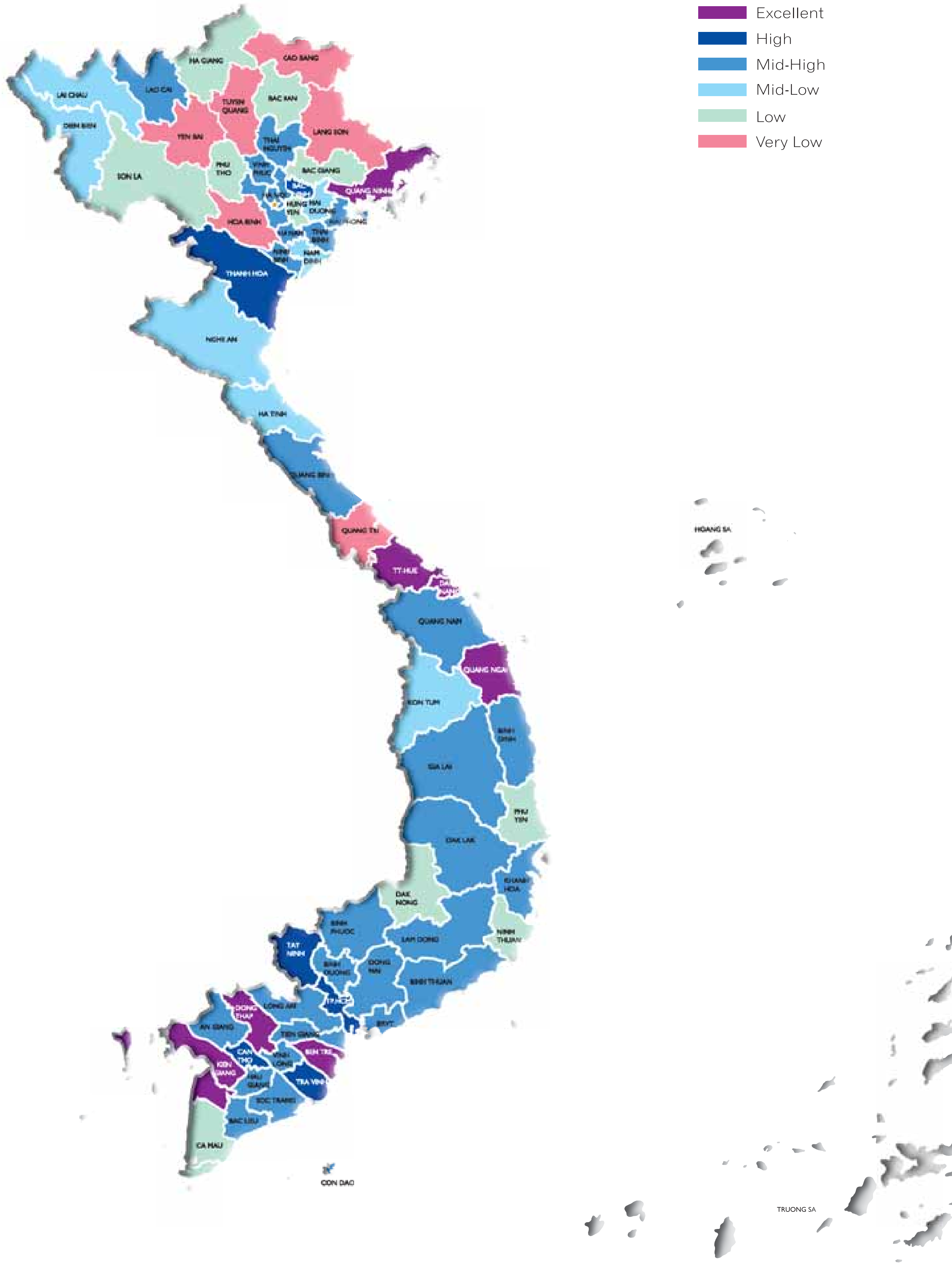
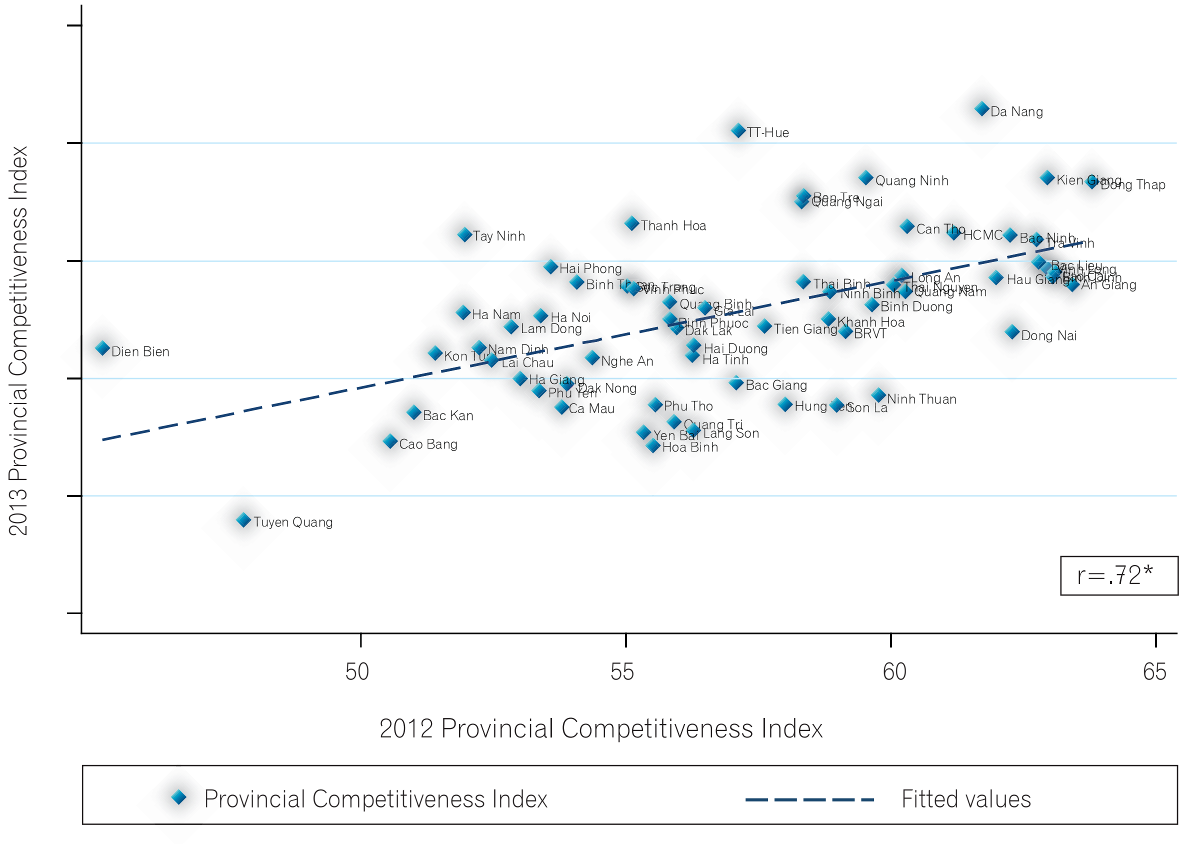

Excellent
High
Mid-High
Mid-Low
Low
Very Low
HA GIANG
CAO BANG
LAI CHAU
LAO CAI
TUYEN QUANG
BAC KAN
DIEN BIEN
YEN BAI
LANG SON
THAI NGUYEN
SON LA
PHU THO
VINH PHUC
BAC GIANG
QUANG NINH
HUNG YEN
HAI DUONG
HAI PHONG
HOA BINH
HA NAM
THAI BINH
NINH BINH
NAM DINH
THANH HOA
NGHE AN
HA TINH
QUANG BINH
QUANG TRI
TT-HUE
QUANG NAM
QUANG NGAI
KON TUM
BINH DINH
GIA LAI
PHU YEN
DAK LAK
KHANH HOA
DAK NONG
BINH PHUOC
LAM DONG
NINH THUAN
TAY NINH
BINH DUONG
DONG NAI
BINH THUAN
DONG THAP
LONG AN
AN GIANG
TIEN GIANG
BEN TRE
CAN THO
VINH LONG
KIEN GIANG
TRA VINH
HAU GIANG
SOC TRANG
BAC LIEU
CA MAU
CON DAO
HOANG SA
TRUONG SA

Figure 1.5 | **Correlation between 2013 and 2012 PCIs**



> "This year the central city of Da Nang and Thua Thien Hue (TT-Hue) province stand out even among the excellent tier with new PCI scores above 65."

This year the central city of Da Nang and Thua Thien Hue (TT-Hue) province stand out even among the excellent tier with new PCI scores above 65. Neither province is a surprise at the top of the index. Until 2010, Da Nang had ranked either one or two in every single PCI report. Although it dropped to its lowest rank twelfth in 2012, Da Nang leaders pledged to learn from their scores and return to the top of the index.[6]

TT-Hue also has an excellent history with the PCI. Since 2007, the province has only ranked below the top 25 provinces and "Very Good" tier once. It ranked 10th and 14th respectively in 2008 and 2009. Moreover, as we highlighted in last year's report (p33),[7] TT-Hue has legislated the strictest

6 Da Nang Today, 2012.
7 See Malesky (2013, p. 33).

commitment to PCI success observed anywhere in the country. Since 2007, it has issued seven informal documents (i.e. Strategic Plans) and three binding People's Committee Decisions. Like Da Nang, TT-Hue has consistently emphasized a goal of reaching the top of the PCI index, and have a clearly articulated a plan for achieving it.

Also represented in the Excellent tier are the perennial success stories of the Mekong Delta: Dong Thap (63.35) and Kien Giang (63.55). In the history of the PCI, Dong Thap has never ranked below eleven, peaking by reaching the top spot in 2012. Kien Giang has slowly climbed up the ranking over time, ranking 6th last year.

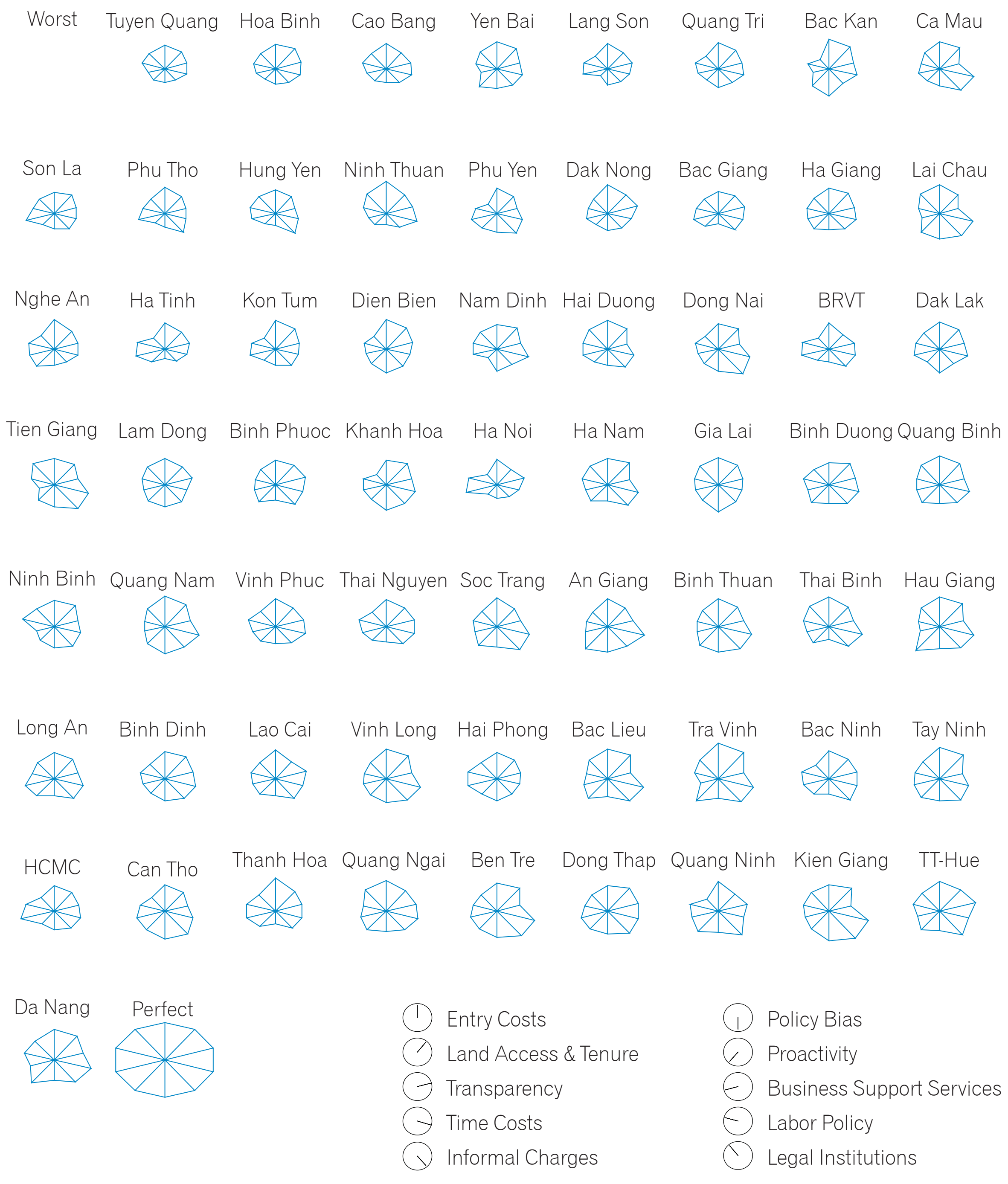
Quang Ninh (with an average PCI ranking of 18 and top rank of 7 in 2010) and Ben Tre (with an average PCI ranking of 16 and top rank of 7 in 2008) are also no strangers to the top echelon of the PCI. Indeed for years, Ben Tre was consistently the best performing province in the ranking of Informal Charges.

The only surprise at the top of the index is Quang Ngai, which ranks 7th this year. This score is a remarkable improvement for the province, which has an average PCI score between 2006 and 2012 of 38.5 and has never ranked higher than 18th. It appears that Quang Ngai's improvements, like TT-Hue, may result from a provincial commitment to improve its governance that is reflected in local policy documents.[8]

On the other side of the ledger is the notable drop of Binh Duong to a ranking of 30 in the middle of the index. Critically, the province was not a victim of the new methodological changes. Most of the drop in scores was due to Binh Duong's decline on core PCI indicators. To assess the underlying determinants of a province's rankings, it is easiest to visualize the data through a star graph, where sub-indices of the PCI are represented as branches. A province scoring a perfect 10 will have the longest branch for that sub-index. By contrast, a province scoring poorly will have a very small branch.

8 Quang Ngai's Plan on improving PCI (Công văn số 2521/UBND-KTTH ngày 9 tháng 7 năm 2013 về việc cải thiện chỉ số PCI của tỉnh Quảng Ngãi năm 2013 (http://www.baomoi.com/Loi-moi-trong-thi/45/11939327.epi); Quang Ngai's 2014 Socio-Economic Development Plan also emphasizes on improving PCI. http://thuvienphapluat.vn/archive/Quyet-dinh-01-QD-UBND-ke-hoach-ve-nhiem-vu-phat-trien-kinh-te-xa-hoi-nam-2014-Quang-Ngai-vb220181.aspx

Figure 1.6 | **PCI Star Graph by Sub-Index**



Looking at Binh Duong in particular, we can see that the province was hurt primarily by declines in its Entry Costs index. Average registration time in Binh Duong have stayed constant at 15 days, while other provinces have continued to improve, so that the national median score is 10 days. Moreover, Binh Duong achieved only middling scores on experiences with OSS. Less pronounced drops were also recorded in Land and Transparency sub-indices. Binh Duong has historically been a standout in land policy, but strikingly, 35% of respondents still claim that fair compensation is not provided when land is appropriated by the local government for infrastructure or industrial zone construction. In Transparency, 41% of respondents claim that relationships are necessary to access critical provincial documents, up from 37% in 2008. Finally, in the new Policy Bias index, respondents did claim that they were facing unfair competition from firms with special connection to policy makers, and to a lesser extent, SOEs.

Lao Cai, a previous champion, also exhibited a slide to ranking of seventeen in the Mid-High category. Lao Cai was also hurt by declines in core indicators, slipping in Entry Costs, Land Policy, Transparency, Time Costs, and Proactivity. Respondents noted a bias in policy making toward firms with connections to the local leadership.

1.3 THE 2013 PCI INFRASTRUCTURE INDEX

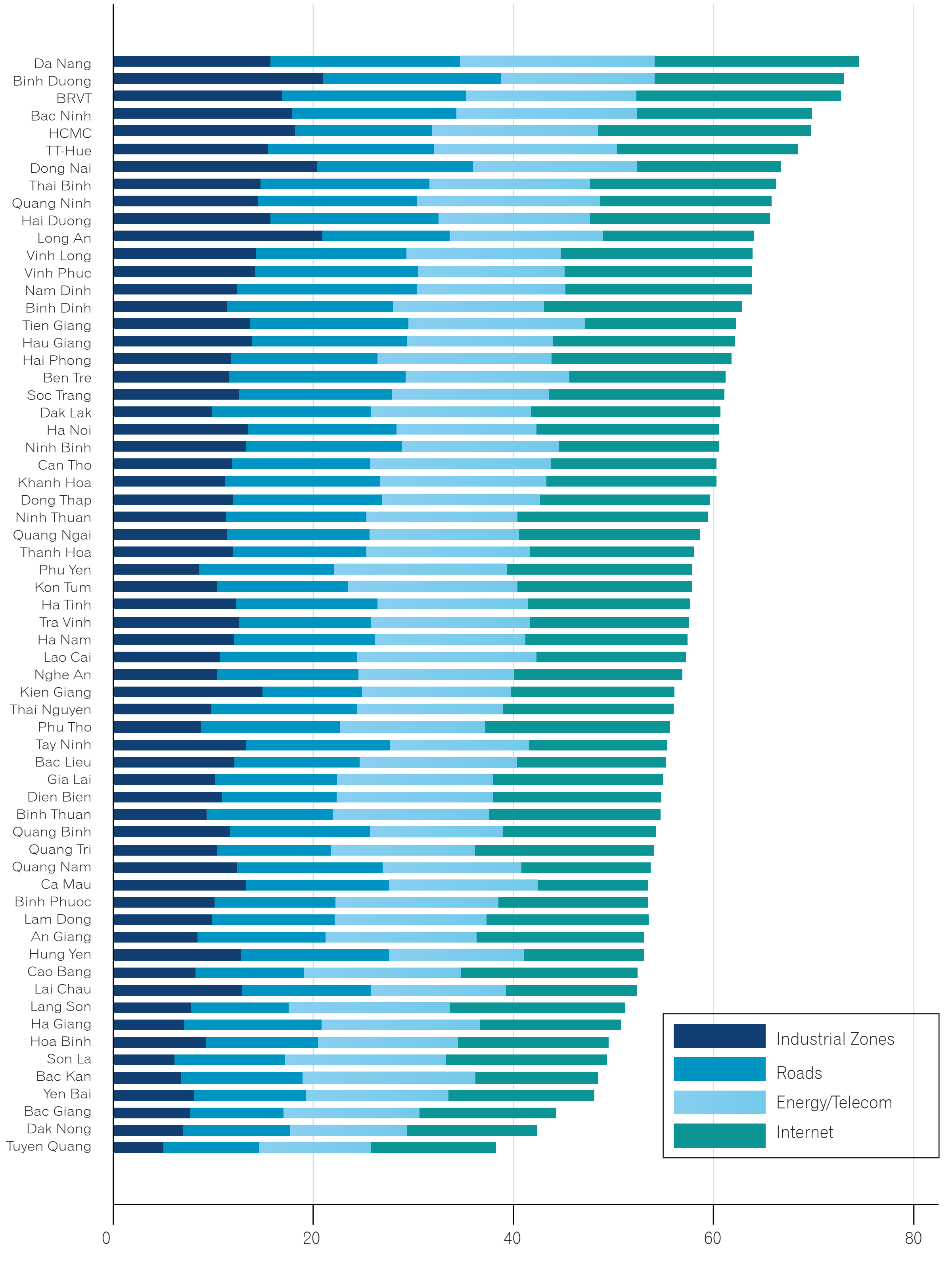
Between 2008 and 2011, the PCI recorded a measure of infrastructure quality alongside the governance measures. Last year, we dropped this ranking to focus on other objectives, such as digging deeper into the question of labor quality and access to finance. What we didn't understand at the time was how popular the infrastructure side project had become. A large number of foreign and domestic businesses called the VCCI office to ask for the measure, which had apparently become extremely popular in informing decisions about local expansion.

Consequently this year - by popular demand - the research team continued our tracking on the quality of infrastructure at the provincial level as business owners and policy makers continue to cite it as one of the most critical barriers to investment and growth in the country. The PCI Infrastructure Index is divided into four sub-indices (See Appendix for details on individual indicators and average score):

- Industrial zones: measuring the availability and quality of local industrial zones;
- Road and transport: gauging the coverage of roads in Vietnam and the indirect costs of transport that result from them;
- Utilities: measuring the costs and reliability of telecommunications and energy delivery in the province; and
- Information and communications technology: measuring access to and usage of information and communications technology.

As in the PCI, each Infrastructure sub-index is a combination of hard data from published sources and perceptions data gleaned from the 8,093 PCI respondents. Figure 1.7 details the final scores on the Infrastructure Index.

FIGURE 1.7 **PCI Infrastructure Index**



Da Nang, Binh Duong, BRVT, Bac Ninh, and HCMC receive the five highest scores. TT-Hue, Dong Nai, Thai Binh, Quang Ninh, and Hai Duong round out the Top 10. Unsurprisingly, the lowest infrastructure scores are in the rural, mountainous region of the country, including Bac Giang, Dak Nong, and Tuyen Quang.

Relationship between Governance and Infrastructure

Figure 1.8 shows the relationship between governance and infrastructure quality, with the dashed blue lines depicting the mean scores on both indices. The northeast corner of the scatter plot shows the provinces that comprise the best total investment environments in the country. These are the provinces that combine above-average governance with above-average infrastructure. Provinces with the best total investment environments include Da Nang, TT-Hue, Binh Duong, Bac Ninh, Quang Ninh and HCMC.

FIGURE 1.8 **Relationship between Infrastructure and Governance**

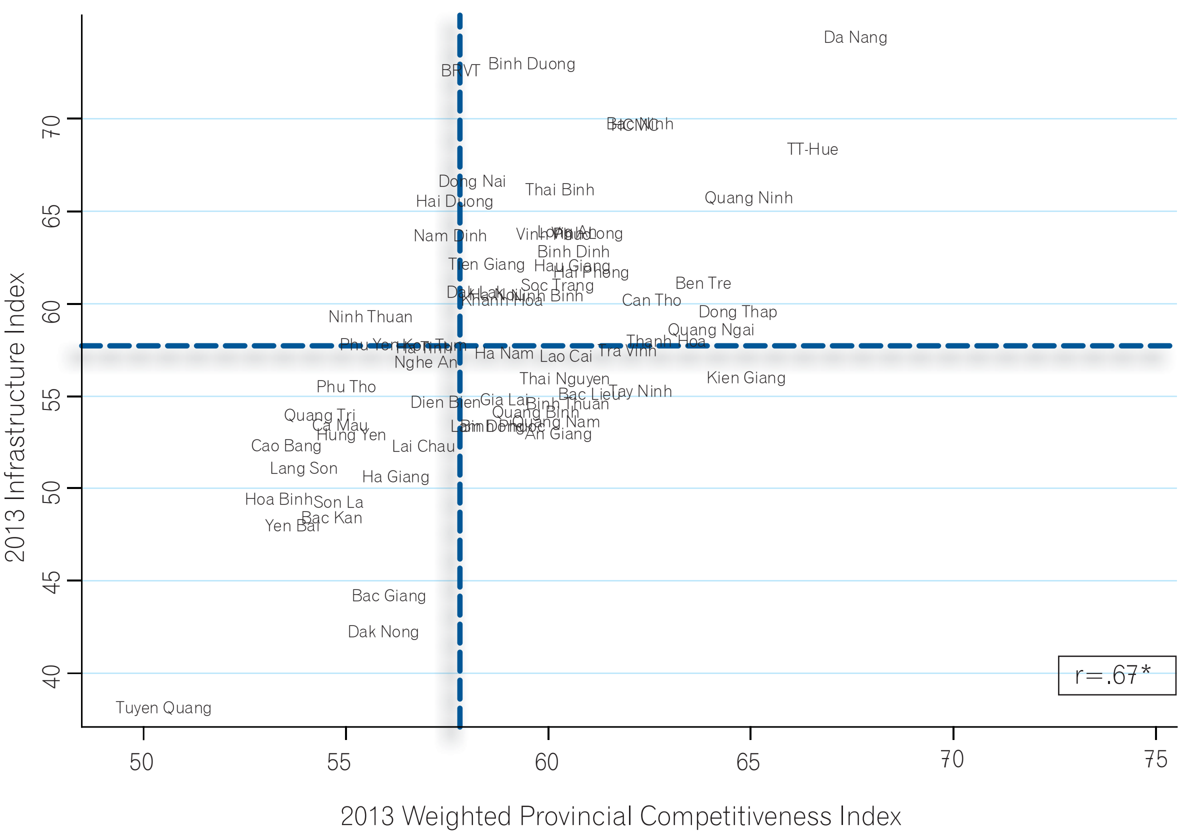


Figure 1.8 also reveals that the Infrastructure Index is positively correlated with good governance (the bivariate correlation is 0.67). There are a number of possible explanations for this correlation that are difficult to disentangle in this report but are worthy of further research. First, it is possible that well-governed provinces are also the provinces that are willing and able to invest resources in high-quality public services, such as infrastructure. Second, there may be wealth effect at work, whereby richer provinces are better endowed with high-quality infrastructure and civil servants. This second factor could result from the long-term benefits of auspicious endowments at the beginning of the reform period, or because of a virtuous circle where governance and infrastructure attract investment that creates revenue for future governance and infrastructure improvements.

The scatter plot does reveal, however, that there are provinces, such as Lao Cai, Tra Vinh, Kien Giang (in the southeast corner), that score below average in infrastructure (denoted by the dashed blue line) but compensate with above-average governance. Since both governance and infrastructure are strongly associated with private sector growth and economic development, these provinces reveal that there are alternative routes to development for poorly endowed provinces.

Caution Regarding Attribution about Infrastructure Quality

The PCI Infrastructure Index, unlike the PCI, is not a definitive evaluation of the quality of local leadership. Many of the indicators measured are out of the control of provincial authorities. Much of the current infrastructure was completed long before the tenure of today's current provincial leaders: some was built in the early central planning years after independence and unification. Provincial officials cannot be held responsible for the infrastructure stock they inherited from a bygone era.

In addition, firms in rural areas have higher transport costs that are inherently difficult to overcome. The mountainous regions offer a harsher and more expensive terrain for building major thoroughfares than provinces in the Red River Delta. Many Mekong Delta provinces use waterways as their primary means of transport, but because many of these waterways are quite small, transport companies cannot realize economies of scale from packing products in large containers. Often, products must be reloaded after passage on the Mekong River before being sent on to the nearest port.

Many infrastructure decisions are made by central government planners. Provinces can supplement infrastructure spending out of their own budgets, but poorer provinces do not have this option and must depend on central transfers. Winning some national infrastructure monies is occasionally dependent on who has better access to central officials or is able to plead the case for central supplements more persuasively. It makes little sense to reward or punish provincial officials based on the success of their lobbying efforts.

Finally, linkages of infrastructure across provincial borders affect firm perceptions in ways that are difficult to disentangle using provincial-level survey data. It would be unfair to rank province A below its neighbor, province B, simply because central authorities selected B as the sight of the national highway. Alternatively, a province that has done a good job of marshalling local resources for new roads and maintenance may be downgraded by firms that are forced to ship products outside those provincial borders over the roads of neighbors that may not have been so diligent about infrastructure development and upkeep. Consequently, the Infrastructure Index is simply an assessment of total infrastructure quality. We make no assumptions about credit or culpability and present it simply as a tool to inform the investment decisions of local entrepreneurs and the policy priorities of central and local officials.

1.4 THE CORE PCI

We recognize that changes in the PCI methodology damage longitudinal analysis, impeding the ability of provincial officials to gauge their reform progress with a constant measure of economic governance over time. Beginning in 2009, therefore, we have created a Core-PCI that tracks changes in PCI progress using a streamlined set of indicators that are available in all iterations of the PCI reports going back to 2006. In 2009, we acknowledged a hesitancy to publish the measure because of fears that it might confuse end-users.[9] We did make it available to researchers who wanted to use it in academic research.[10] This year, however, after some deliberation we have decided to more explicitly analyze the Core PCI, because the nine-years of panel data present critical information about the current status of Vietnam's economic reform progress.

Table 1.7 presents the consistent indicators used in the Core PCI over time. For all of these indicators, the wording of questions has not been altered, the re-scaling procedures have not changed, and the construction is the same as in 2006. At times, the order in which questions have been asked in the survey has shifted somewhat, so that transparency questions are encountered a few pages later in the survey than in previous years. Nevertheless, these small questionnaire design issues do not seem to have much effect on the index.

9 Malesky 2009, Page 47, fn. 22.
10 See Schmitz, H. et al. 2012.

TABLE 1.7 **Indicators used in the Core PCI**

Item	Source
Sub-Index 1 – Entry	
1. Length of business registration in days (median)	PCI Survey Question: C1
2. Length of business re-registration in days (median)	PCI Survey Question: C2
3. Median number of days to wait for Land Use Rights Certificate	PCI Survey Question: B4.2
4. Percentage of firms waiting for more than one month to complete all steps necessary to start operations	PCI Survey Question: C5
5. Percentage of firms waiting more than three months to complete all steps necessary to start operations.	PCI Survey Question: C5
Sub-Index 2 – Land Access and Security	
1. Percentage of firms that own land and are in possession of an LURC	PCI Survey Question: B1 and B4
2. Percentage of land that has been registered and provided with official LURCs	Ministry of National Resources and Environment (MONRE)
3. Firms' rating of expropriation risk (from 1-Very High to 5 -Very Low)	PCI questionaire: B4.3
Sub-Index 3 – Transparency	
1. Access to planning documents (1=easy to access; 5= impossible to access)	PCI Survey Question: F1.1-F1.13
2. Access to legal documents (1=easy to access; 5= impossible to access)	PCI Survey Question: F1.1-F1.13
3. Relationship important or very important to get access to provincial documents (% Important or Very Important)	PCI Survey Question: F2
4. Negotiations with tax authority are an essential part of doing business (% Agree)	PCI Survey Question: D14.3
5. Predictability of implementation of central laws at the provincial level (% Usually or Always)	PCI Survey Question: F8
Sub-Index 4 - Time Costs of Regulatory Compliance	
1. Percentage of firms spending over 10 percent of their time on understanding and complying with regulations	PCI Survey Question: D6
2. Median number of inspections (all agencies)	PCI Survey Question: D1
3. Median tax inspection hours	PCI Survey Question: D4

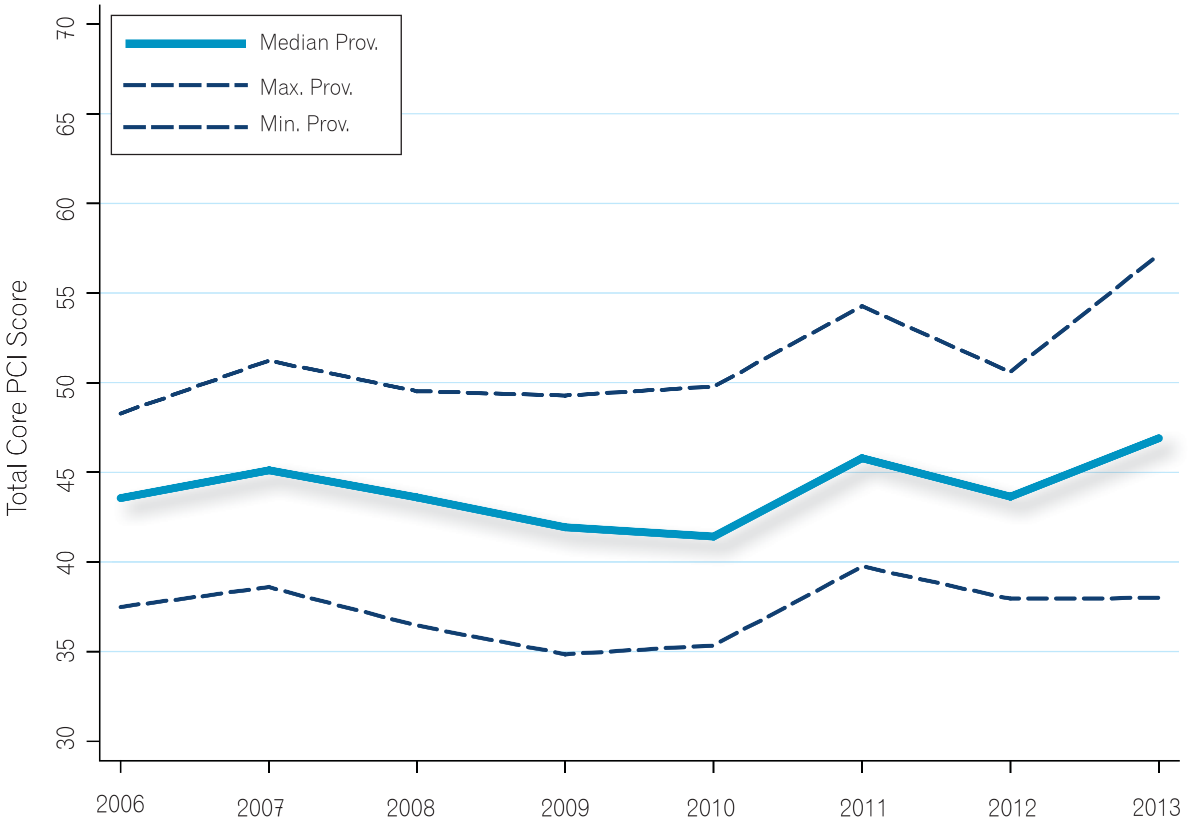
Sub-Index 5 - Informal Charges	
1. Enterprises in my line of business usually have to pay for informal charges (% Agree)	PCI Survey Question: D10
2. Percentage of firms paying over 10 percent of their revenue for informal charges	PCI Survey Question: D11
3. Rent-seeking phenomenon is popular in handling administrative procedures for businesses (% Agree)	PCI Survey Question: D14.2
4. Percentage of firms saying that informal charges usually or always deliver expected results	PCI Survey Question: D12
Sub-Index 6 - Policy Bias	
1. Province gives privileges to state-owned holding companies or corporations, causing difficulties to your business (% Agree)	PCI Survey Question: H4
2. Province gives priority in solving problems and difficulties to foreign companies over domestic one (% Agree)	PCI Survey Question: H2.7
3. "Contracts, land, …, and other economic resources mostly fall into the hands of enterprises that have strong connections to local authorities" (% Agree)	PCI Survey Question: H5
4. Preferential treatment to big companies (both state-owned and nonstate) is an obstacle to their business operations (% Agree)	PCI Survey Question: H.2.5
Sub-Index 7 - Proactivity	
1. Firms' assessment of the attitude of provincial government toward private sector (% Very Positive or Very Positive)	PCI Survey Question: H1
2. The PPC is flexible within the legal framework to create a favorable business environment for nonstate firms (% Agree)	PCI Survey Question: H2.2
3. The PPC is very proactive and innovative in solving new problems (% Agree)	PCI Survey Question: H2.3
Sub-Index 8 - Business Support Services	
1. Number of trade fairs held by province in previous year and registered for present year (Ministry of Industry and Trade)	VietTrade, Ministry of Industry and Trade
2. Ratio of the number of service providers to the total number of firms	General Department of Taxation
3. Ratio of the number of nonstate and FDI service providers to the total number of service providers (General Department of Taxation data)	General Department of Taxation
4. Firm has used business information search services (%)	PCI Survey Question: E6

5. Firm used private provider for business information search services (%)	PCI Survey Question: E6
6. Firm intends to use business information search services again (%)	PCI Survey Question: E6.1
7. Firm has used consulting on regulatory information (%)	PCI Survey Question: E6
8. Firm used private provider for consulting on regulatory information (%)	PCI Survey Question: E6
9. Firm intends to use regulatory consulting services again (%)	PCI Survey Question: E6.1
10. Firm has used business match making services(%)	PCI Survey Question: E6
11. Firm used private provider for business match making services (%)	PCI Survey Question: E6
12. Firm intends to use business match making services again (%)	PCI Survey Question: E6.1
13. Firm has used trade promotion services (%)	PCI Survey Question: E6
14. Firm used private provider for trade promotion services (%)	PCI Survey Question: E6
15. Firm intends to use trade promotion services again (%)	PCI Survey Question: E6.1
16. Firm has used technology related services (%)	PCI Survey Question: E6
17. Firm used private provider for technology related services (%)	PCI Survey Question: E6
18. Firm intends to use above service provider again for technology related services (%)	PCI Survey Question: E6.1
Sub-index 9 – Labor Quality	
1. Services provided by provincial agencies - general education (% Very Good or Good)	PCI Survey Question: E1.7
2. Services provided by provincial agencies – vocational training (% Very Good or Good)	PCI Survey Question: E1.8
3. Firm has used labor exchange services (%)	PCI Survey Question: E6
4. Firm used private provider for above labor exchange services (%)	PCI Survey Question: E6
5. Firm intends to use labor exchange services again (%)	PCI Survey Question: E6.1
6. Overall satisfaction with Labor (% Agreeing labor meets firm needs)	PCI Survey Question: E9
7. Ratio of vocational training school graduates to untrained laborers	Ministry of Labor, Invalids and Social Affairs
8. Laborers with technical training as % of workforce	Ministry of Labor, Invalids and Social Affairs

Sub-index 10 – Legal Institutions	
1. Legal system provided mechanism for firms to appeal against officials' corrupt behavior (% Always or Usually)	PCI Survey Question: G2
2. Firm confident that legal system will uphold property rights and contracts (% Strongly Agree or Agree)	PCI Survey Question: G1
3. Cases filed by by non-state entities at Provincial Economic Courts per 100 firms (Supreme Court)	People's Supreme Court
4. Non-state claimants as a percentage of claimants at Provincial Economic Courts (Supreme Court)	People's Supreme Court

Figure 1.9 plots changes in our index using consistent PCI indicators over time (2006 to 2013). The chart plots changes in the median province (straight line) along with scores by the maximum and minimum performers (with dashed lines). Visualizing the data this way, we see the long stagnation and even decline in provincial economic governance that took place between 2007 and 2010. This process reversed somewhat in 2011, as the Core PCI jumped back to its pre-WTO levels. Last year (2012) was a setback, which we discussed at length in the 2012 report, as firms expressed renewed disappointment in the time costs of regulatory compliance, bias toward SOEs and connected firms, and labor policy.

FIGURE 1.9 **Changes in Core PCI over Time**



Viewed through the lens of the Core PCI, 2013 shaped up to be a good year. The median province scored 47 on the consistent measure reached; the highest score recorded since we start keeping track.

Figure 1.10 sheds light on the factors behind the changes by depicting the score of the median province on the ten sub-indices over time. The one index that shows consistent progress upward has been the improvement in managing informal charges. We noted this trend last year and it continues to be the case that the frequency and cost of petty corruption, small bribes to facilitate regulatory transactions, are declining for businesses in Vietnam. Some authors have argued that this has to do with the benefits of economic growth and the increased inter-provincial mobility of businesses.[11]

11 Bai, J. et al. 2013.

This is a positive trend, but it is important to note that it is limited to petty corruption faced by firms. It is not clear how growth would affect petty corruption that is experienced by households, as they seek to comply with regulations and supplement poor public services, such as schooling and medical care.[12] Similarly, the PCI can tell us little about trends in grand corruption, such as kickbacks on government procurement or sweet heart land deals.

FIGURE 1.10 **Changes in Sub-Indices of Core PCI over Time**

[12] These are the types of corruption measured by the annual UNDP-PAPI survey (Acuna-Alfaro et al. 2013) See http://www.papi.vn/about-papi for further details.

Progress on Entry Costs has also been extremely stable up until this year when it declined slightly. As we have noted consistently throughout the PCI reports, most provinces have invested great effort into facilitating business entry through reforms of business registration offices, reduced licensing requirements, and OSS. As a result, the median province now scores close to a nine on the ten-point index. There is little more that can be done here, and innovation and effort could best be applied elsewhere.

Land, Transparency, and Business Services have had more erratic trajectories, jumping up and down slightly. Nevertheless, they all appear to be showing signs of upward trends in the past year. More businesses are able to obtain LURCs and feel confident about their security. More managers are able to access basic provincial planning documentation and legislation. And more firms are able to find contractors (now, in the private sector) that can help them identify market information, access new markets, and learn about new technology for their businesses. These are positive developments that bode well for the future.

More worrying, however, are continuing declines in two other indicators. As we highlighted in Section 1.1, firms continue to feel that the playing field is tilted against the private, domestic sector. Particularly problematic has been the belief that firms with former connections to provincial leadership, especially equitized firms and those managed by former officials, are getting favorable access to land, capital, and procurement contracts.

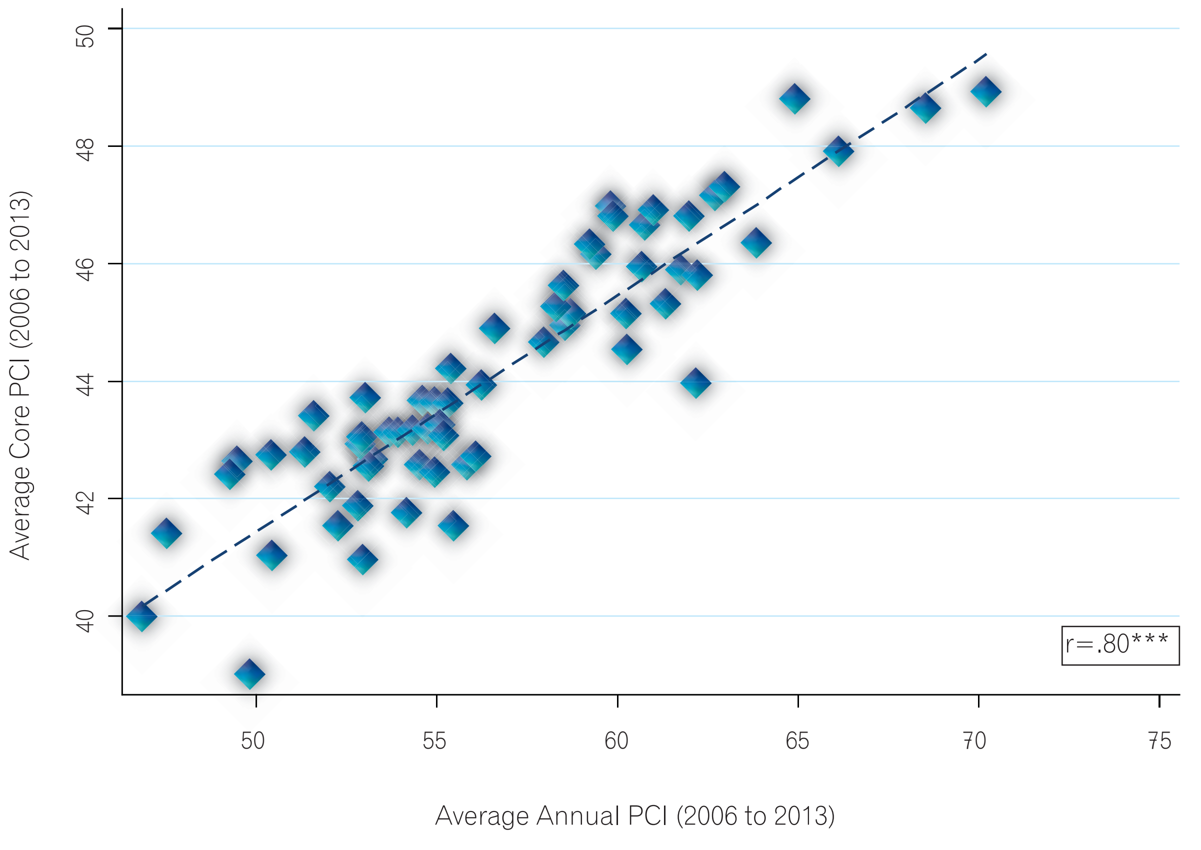
Relatedly, firms are documenting that the proactivity of the provincial leaderships and their attitude to the private sector has consistently eroded since its high in 2007. In the 1990s and early 2000s, fence-breaking by reform minded provinces was a critical factor generating economic growth and developing policy innovations that would be later adopted at the national level.[13] Although it is not clear why, provinces appear to be reducing that role over time, and their private firms have noticed.

Analysis of Individual Provinces on Core PCI

One methodological worry is that the Core PCI offers a radically different picture of economic governance than the annual PCI, because it is based only on indicators that were important in 2005. If this is the case, rankings and success stories might diverge over time. As Figure 1.11 shows this does not appear to be the case. The correlation between the Annual PCI and Core PCI is 0.8 and is strongly significant.

13 Jandl, T. 2013, Kerkvliet, B. J. .2005, and Fforde, A., & De Vylder, S. 1996.

FIGURE 1.11 **Correlation between Average Annual PCI and Core PCI (2006 to 2013)**



In less statistical jargon, many of the same provinces that score well on the Annual PCI also have high scores on the Core PCI. The same is true of bottom-ranking provinces. Table 1.8 provides a different take on this by showing average scores on the Annual PCI and Core PCI between 2006 and 2013. Seven of the top ten scores in the Annual PCI (in bold letters) are also found in the top ten Core PCI provinces. There is a bit more instability of at the bottom of the index, but we can still identify four provinces that reappear in both measures.

TABLE 1.8 Top Performers in Annual PCI, Core PCI, and Infrastructure

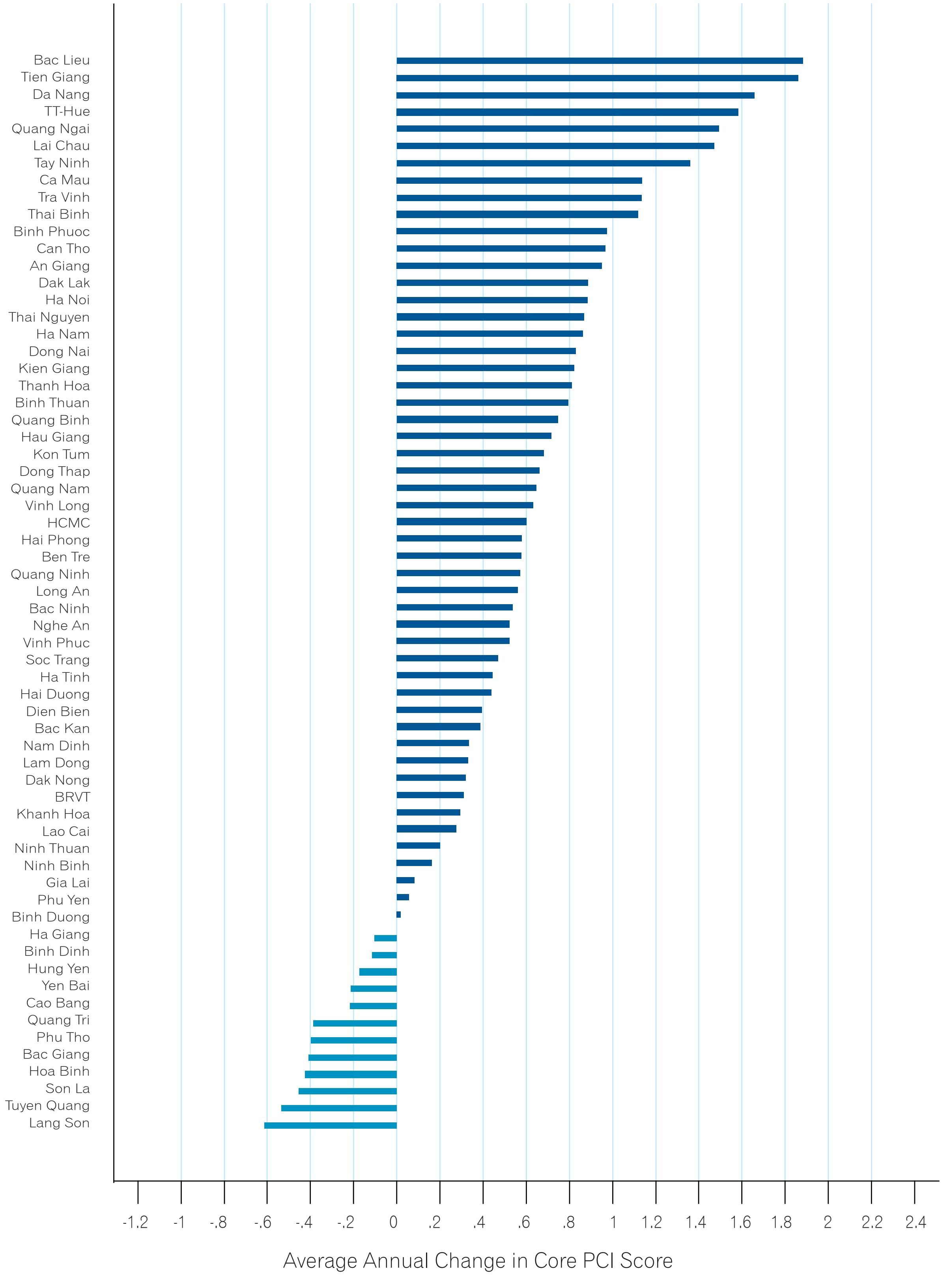
Average Annual PCI		Average Core PCI		Average Infrastructure	
70.23	Da Nang	48.95	Da Nang	79.50	Binh Duong
68.51	Binh Duong	48.78	Dong Thap	73.62	Da Nang
66.11	Lao Cai	48.64	Binh Duong	70.50	Dong Nai
64.90	Dong Thap	47.91	Lao Cai	70.01	HCMC
63.85	Vinh Long	47.28	Binh Dinh	69.28	BRVT
63.01	Binh Dinh	47.18	Vinh Phuc	69.01	Vinh Phuc
62.72	Vinh Phuc	46.93	Quang Ninh	68.29	Hai Duong
62.23	An Giang	46.90	Ben Tre	68.22	Thai Binh
62.12	HCMC	46.80	Bac Ninh	67.39	Bac Ninh
61.98	Bac Ninh	46.68	Tra Vinh	67.09	Ha Noi
Average Annual PCI		Average Core PCI		Average Infrastructure	
52.02	Bac Lieu	42.22	Bac Lieu	52.34	Dien Bien
51.56	Son La	41.89	Nam Dinh	51.83	Hoa Binh
51.32	Hoa Binh	41.76	Hai Phong	51.33	Kien Giang
50.44	Lang Son	41.55	Ha Noi	51.20	Ha Giang
50.38	Kon Tum	41.54	Tuyen Quang	50.11	Bac Kan
49.80	Bac Kan	41.38	Cao Bang	49.82	Tuyen Quang
49.47	Dien Bien	41.04	Lang Son	47.62	Lai Chau
49.27	Lai Chau	40.96	Nghe An	47.38	Cao Bang
47.50	Cao Bang	39.99	Dak Nong	46.37	Son La
46.84	Dak Nong	39.00	Bac Kan	45.82	Dak Nong

> " *Jumping out of the graph is an extremely positive story – 51 out of 63 provinces (81%) have demonstrated positive improvements since 2006* "

Because the Core PCI uses the exact same indicators and weighting methodology, it has the helpful feature that we can track progress by individual provinces over time. Figure 1.12 presents the average annual change of each province measured in the PCI survey over time. Jumping out of the graph is an extremely positive story – 51 out of 63 provinces (81%) have demonstrated positive improvements since 2006 (shown with dark blue bars). While provinces have moved up and down the rankings, there has been a general march toward better economic governance. Change has not been dramatic, even the fastest improvers like Bac Lieu and Tien Giang have averaged less than two points on the core PCI per year. This should be especially heartwarming to leaders in Bac Lieu and Ha Noi, which rank in the bottom ten of the average core PCI, but among its top ten in improvement. It is difficult for change governance, and even more difficult to businesses to recognize and appreciate those changes, but these accomplishments are being documented and recorded in the PCI.

On the other end of the spectrum are provinces that have slipped in the rankings (marked in light blue). In addition to the smaller share of provinces in this group, another positive sign is that the magnitude of the downward shifts is quite small. The decline was recorded in Lang Son (about 0.6 points a year), which is about one-third of the improvement at the top end. Unfortunately, the declining group includes some important investment locations and former PCI stars, such as Binh Duong, Binh Dinh, and Hung Yen.

FIGURE 1.12 **Average Annual Provincial Changes on Core PCI (2006 to 2013)**



1.5 CONCLUSIONS

The analysis of the Core PCI is a helpful indicator that there appears to be sunlight ahead on the Vietnamese horizon. Business confidence appears to be negative, but confidence is an outcome of changes in governance that improve the business environment. The Core PCI is capturing important changes in informal charges, transparency, and security of business premises that will improve the prospects for investors. Hopefully, these trajectories are positive signs that we will see improvement in business confidence and ultimately investment in the coming years.

> " …Private, domestic investors are still deterred by perceived biases in policy-making and declining proactivity of local leaders….firms continue to believe that there is a shortage of high quality labor that suits the needs of their business. "

That said, there is still room for important changes in Vietnamese policy-making. Private, domestic investors are still deterred by perceived biases in policy-making and declining proactivity of local leaders. In their minds, they are not receiving the type of local support that they provided to SOEs and connected firms. Another concern is that firms continue to believe that there is a shortage of high quality labor that suits the needs of their business. Further work on these issues will be necessary for Vietnam to reach its growth potential.

As they proceed down this reform path, provincial leaders can feel confident that the PCI research team will continue to provide them with timely and objective data on their progress. The revamped and recalibrated annual PCI is more suited than ever to capture these new policy changes. This index will not be changed until 2018, allowing leaders to measure their progress over time. At the same time, the Core PCI is still available if leaders and businesses who want to track economic governance in Vietnam back to the beginning of the millennium.

PCI 2013

THE VIETNAM PROVINCIAL COMPETITIVENESS INDEX 2013

2 THE FOREIGN INVESTMENT SURVEY

SUMMARY FINDINGS

This chapter summarizes the results of the fourth annual PCI foreign direct investment (FDI) survey. The survey covers a highly representative selection of 1,609 businesses from 49 different countries, whose operations are located in the thirteen Vietnamese provinces with the highest concentrations of foreign invested enterprises (FIEs), according to the General Statistical Office (GSO). As in the survey of domestic firms, the PCI-FDI respondents are selected from the General Tax Department (GTD) list, using a stratified random sample at the province level to ensure that the representation of foreign firms in the sample mirrors the underlying provincial population. While the PCI-FDI survey is not the only survey of foreign investment in Vietnam, it is the largest and most comprehensive. In fact, the number of respondents in the PCI-FDI module accounts for 10.1% of the entire population of foreign invested projects (15,904) that have been registered in Vietnam since 1988 according to the GSO, and is roughly equal to the amount of new FIEs that entered Vietnam in 2012.

It is critical to note that only domestic, private firms are included in the construction of the PCI. FDI firms are separated and analyzed independently in this chapter, because a large number of provinces do not have sufficient numbers of FIEs to confidently generalize about their provincial business environments. In addition, as FIEs have the luxury of selecting the province in which they want to operate, they tend to have a different relationship with local governments than domestic firms, which usually operate solely in their home province.

This chapter is divided into five sections. In Section 2.1, we explore the performance of FIEs in the past year, demonstrating that while actual revenue and profitability have increased, respondents record increasing pessimism about their performance. In Section 2.2, we profile the average FIE in Vietnam, finding that they are predominantly from neighboring Asian countries (especially Taiwan, South Korea, and Japan), are relatively small in both employment and investment size, have the majority of their operations in low-end manufacturing, and are primarily interested in the export market for their products. In Section 2.3, we study how firms rank Vietnam in the competition for FDI against the country's immediate rivals and home country policies. Section 2.4 extends the analysis to a selection of provinces in Vietnam, demonstrating that foreign firms try compensating (as best they can) for national weaknesses in their subnational locational decisions.

In Section 2.5, we offer a special analysis of "transfer mispricing" in the country. Our primary objective is to determine the scale and drivers of "transfer mispricing" in Vietnam, in order to help the country identify potential policy solutions. We have no intention of casting aspersions on any particular actor or industry. We only seek to identify common patterns that can be used to identify a way forward. We begin by using an embedded survey experiment to demonstrating that about 20% of FIEs engage in the (often legal) practice. But this is just the first step. Next, we demonstrate statistically that the activity would be significantly reduced if Vietnam implements a more predictable and less volatile tax policy. The results of the transfer mispricing analysis provide a clear policy solution for Vietnamese officials. Even without drastic changes in the tax rates, if policy-makers could ensure firms a predictable tax schedule in the future, so that businesses can adequately estimate their future burden, those business are extremely more likely to refrain from transfer mispricing – keeping vital revenue in the country that can be used to offset the public services and infrastructure that investors cite as Vietnam's most important strategic disadvantages. The finding also conforms with FIEs' consistent belief that Vietnam is over-regulated relative to its peers. In this case, over-regulated does not mean the total amount of regulations but their instability, especially in tax policies. Part of the problem is that the frequent changes in Vietnamese taxes (especially customs, personal income tax, and end-user fees) impose expensive costs on firms who must develop new strategies for addressing these changes.

2.1 PERFORMANCE OF FOREIGN FIRMS IN 2013

Although the difficulties in the Vietnamese economy continued into 2013, the performance of FIEs does appear to be slightly better than in 2012. Sales remained steady, but firm profitability increased marginally. The median FIE in the PCI-FDI survey recorded a gross revenue of $2 million, about the same as 2012 and down from 2011. Of course, profitability measures should be treated with caution on a self-administered survey, but compared to 2012, there appears to be a noticeable uptick in performance. Sixty-four percent of FIEs report profits this year – up four percentage points from 2012, while only 24% of firms reported losses. Moreover, of those reporting profits, 10.7% answered that their margins were greater than 5%.

" Interestingly, while performance is improving, FIEs are somewhat pessimistic about their growth trajectories. Although 33% of FIEs added labor this year, this is still down from the 50% recorded in 2010. "

Interestingly, while performance is improving, FIEs are somewhat pessimistic about their growth trajectories. Although 33% of FIEs added labor this year, this is still down from the 50% recorded in 2010. More worrisome, however, only 5% of FIEs increased investments in ongoing operations. Looking ahead to the next two years, according to the Business Thermometer, pessimism continues to grow. Whereas in 2010, 68% of operations planned to expand their operations in Vietnam, this year, only 28% were as optimistic about their business plans in Vietnam.

TABLE 2.1 **Performance of Foreign Firms over Time**

Year	Firms Increasing Investment	Median K Size ($ Million)	Firm Adding Employees	Median Size (Employees)
2010	37.3%	2.0	54.0%	90
2011	27.8%	1.5	47.1%	85
2012	5.1%	1.5	32.2%	87.5
2013	5.1%	1.4	33.4%	125
Year	**Firms Reporting Profits**	**Firms Reporting Losses**	**Firms Intending to Expand**	
2010	70.1%	24.6%	68.5%	
2011	73.9%	20.5%	45.5%	
2012	60.0%	28.0%	32.7%	
2013	64.1%	23.8%	28.2%	

2.2 CHARACTERISTICS OF THE FIE RESPONDENTS

As we reported in previous years, the median FIE in Vietnam remains relatively small, export-oriented, and operating a low-margin business that is subcontracting to a larger multinational producer—and is therefore usually situated in the lowest node in a product's value chain (see Table 2.3).

Size: Foreign operations in Vietnam are quite small by international standards. The median size of an FIE is about 125 employees and 77% of FIEs in Vietnam have less than 300 employees. Indeed, 38% have less than 50 employees. A few sizable operations are represented in the PCI survey. About

100 operations have over 1,000 employees. We find similar results when we disaggregate by capital size—the median operation is $1.5 million and 73% of FIEs have licenses that are less than $2.5 million. Only 5% of the sample is licensed for investments greater than $25 million.

Type of Investor: 92% of the FIE respondents are 100% foreign-owned. This figure, which is in agreement with the GSO Enterprise Census, is remarkable because early in the Vietnamese investment history (1987–1991), 100 percent foreign-owned investment was not allowed and investors were obligated to joint venture with SOEs. While 100 percent FDI was possible under the 1991 revision to the Foreign Investment Law (FIL), it was still difficult, as access to land hinged heavily on finding a state-owned local partner. The 1996 revisions of the FIL facilitated 100% direct investment and led to the dominance of this foreign owned form that we observe today.

Sector: 64% of operations are in manufacturing, while only 33% of FIEs operate in the services sector. Dissecting manufacturing a bit more precisely, we find that the three biggest sectors are apparel, rubber and plastics, and vehicle manufacturing (all accounting for about 6% of the sample). Textiles, food processing, chemical products, paper products, electronics and computer products follow with about 3% of the sample each. Other sectors, such as leather, machinery, and metal fabrication account for less than 2%. The most populated service sectors are wholesale and retail trade (8.3%), information and communications (5.6%), and construction (4%). While some have raised serious concerns about a migration of FIEs into the real estate market, our data do not show it. Less than one percent of FIEs were licensed for real estate activities (although more may be involved as sideline investments).

Customer: Exports still account for a large share of FIE sales, but are no longer dominant; 34% of all firms and 43% of manufacturing enterprises export more than half of their output directly or indirectly. Even the output sold within Vietnam is often sold to foreigners, as 36% of FIEs list foreign individuals or companies in Vietnam as their primary market. One positive development from previous years, however, is that a much larger share of sales (42%) is being sold to private individuals in Vietnam, up from 25% in 2010. Growth among private individuals appears to have replaced sales that were originally targeted at SOEs and state agencies. This could be the result of efforts by the Vietnamese leadership to limit the activities of central SOEs outside of their core competencies. As a result, FIEs have substituted with sales to Vietnamese individuals.

Suppliers: Linkages to the domestic sector appear to be increasing. The PCI survey asks firms to list all of their suppliers of intermediate goods and service. It is possible for a firm to have checked every category. 56% of FIEs source a percentage or all of their intermediate goods and services domestically. In 2011, this number was as low as 42%. Even better, domestic, private operations account for a hefty share of the total (47%), compared to 9% from SOEs. Nevertheless, overseas purchases are still critically important. 10% of operations purchase inputs through their parent companies, 45% buy some goods from home, and 34% purchase from third-country suppliers. The reliance on overseas inputs contributes to the Vietnamese government's concerns about the risk of transfer mispricing in Vietnam, which we explore in detail below.

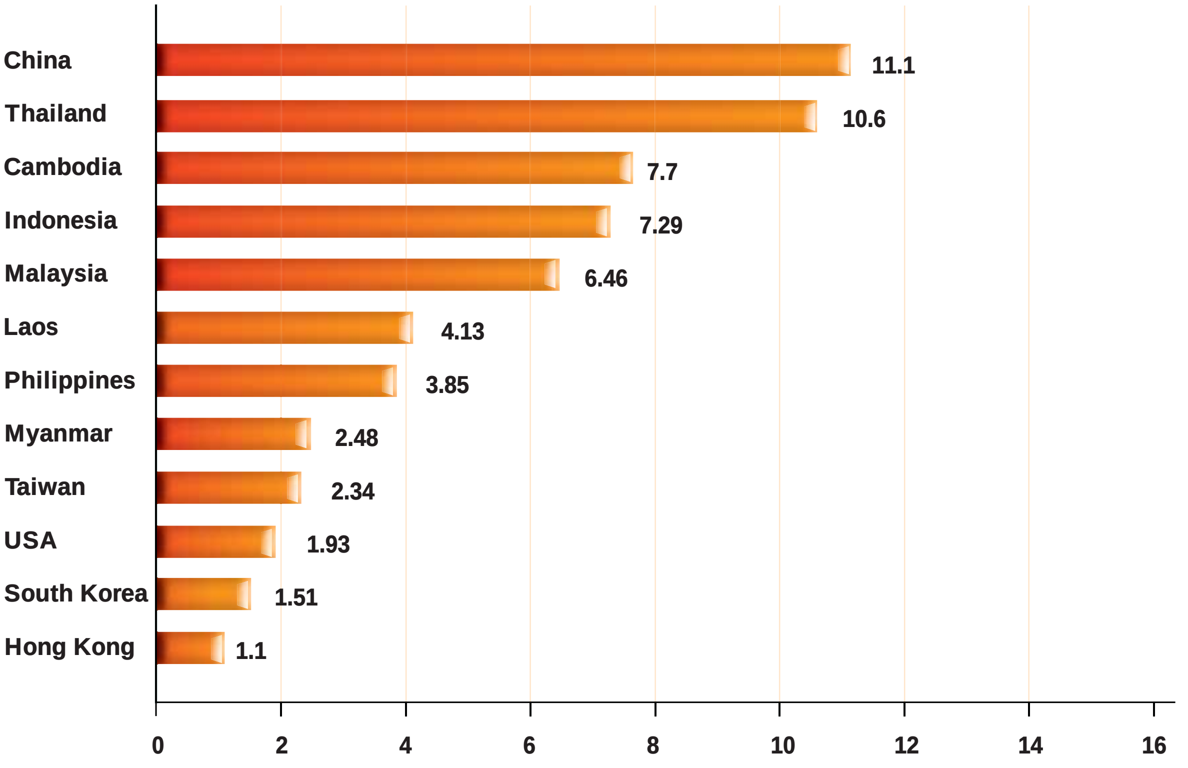
Country of Origin: As in previous years, we find that investors from East Asia dominate the sample. Investors from South Korea, Taiwan, Japan, and mainland China account for 67% of the active businesses surveyed.[14] When we add investors from neighbors in Southeast Asia, the figure approaches 81%. These numbers correspond closely to the calculations made by the Ministry of Planning and Investment (MPI) and GSO. Sizable numbers exist for Western investors as well. The PCI-FDI sample contains 141 investors from Europe and 70 from the United States (including Guam and the U.S. Virgin Islands), 32 from Australia, in addition to a host of others from Russia, Eastern Europe, and Latin America. It is important to note that a great deal of U.S. investment is listed as originating in Hong Kong and Singapore for a variety of logistical and tax-based reasons; so U.S. investment is probably understated.[15]

2.3 VIETNAM'S BUSINESS ENVIRONMENT RELATIVE TO COMPETITORS

In past PCI-FDI reports, we highlighted the fact that FIEs were primarily selecting Vietnam, and specific provinces in Vietnam, based on factors affecting the cost of production, rather than governance. In this year's report, we decided to take a different approach, asking businesses to compare factors in the Vietnamese business environment to other locations in which they considered investing. According to this year's PCI survey, 54% of the FIEs currently in Vietnam considered other countries (most commonly China (11.1%), Thailand (10.6%), and Cambodia (7.7%)) before investing in Vietnam. In 2011 and 2012, the share of FIEs considering other locations was only 32%, so the uptick itself represents an important marker of Vietnam's international standing. Vietnam is no longer the darling of the international community it was between 2007 and 2010, and must now compete against traditional regional destinations for FDI (China, Thailand, Indonesia) along with several new entrants. Three new Southeast Asian neighbors (Laos, Philippines, and Myanmar) appeared on the list, which have not been previously seen as competitors for foreign investment with Vietnam.

14 Vietnam captures as FIEs, firms who are headquartered in Vietnam and have Vietnamese managers, but whose capital is from overseas.
15 Parker et al. 2005.

FIGURE 2.1 **Vietnam's Biggest Competitors for Foreign Investment**



Share of FIEs that considered investing in country over Vietnam (%)

Of investors considering other countries, 69% selected Vietnam over the competition, while 31% invested in Vietnam as part of a multi-country investment strategy. The latter group is particularly interesting, because they are able to offer a vivid comparison of the Vietnamese investment environment relative to the other locations where they have direct experience.

How does Vietnam compare to these other locations? To pin this down directly, the PCI survey asked firms to consider several factors that are important for investment success. For each item, they were asked whether Vietnam offers superior performance to its main competitors. A follow-up question put these scores in context, by comparing Vietnam to the country where their headquarters are located (their home or mother country of their MNC). A final question applied the same set of choices to provincial investment decisions, where firms were asked to compare the province with their Vietnam operations to other provinces they considered.

Table 2.2 offers a summary of the main responses. The table is divided into three panels. The first panel relates Vietnam's scores to its main investment competitors; the second panel studies Vietnam relative to the investors' home countries; and the third panel scores the provinces. Each of the panels provides the average percentage of FIEs agreeing Vietnam is superior along with the standard error, which allows us to observe the variance around responses.

TABLE 2.2 **Competitiveness of Vietnam and its Provinces**

How would you compare the business environment in Vietnam (your current province) to:	1) Other countries where your firm considered investing (QB2)	2) The home country of your firm (Question B3)	3) Other provinces where your firm considered investing (Question B5)
Criteria	**% Agree**	**% Agree**	**% Agree**
I face less corruption	34.2%	22.5%	53%
I face fewer regulatory constraints	43.5%	34.1%	61%
I face lower tax rates	52.4%	49.2%	51%
I face lower risks of expropriation	63.8%	50.7%	61%
I face fewer policy uncertainties	59.7%	44.8%	66%
Infrastructure is better	36.9%	9.0%	85%
Public service delivery is better	31.9%	21.0%	69%
I play a more active role in policymaking	59.2%	46.1%	62%

The results provide a fascinating glimpse into the main priorities of investors, and how Vietnam stacks up on the criteria that firms use to make investment decisions. As an easy benchmark, we can use all scores above 50% to indicate that this is an investment factor where the majority of investors prefer Vietnam to competitors. Scores below 50% indicate areas of weakness.

It is important to acknowledge upfront the selection bias that influences these results. These are FIEs who already chose to invest in Vietnam and not those who weighted the competitive balance in favor of another country by investing there. This means that the satisfaction results are likely over-stated, as they do not include investors who considered these factors to be so problematic that it stopped them from investing in Vietnam. We also don't know how large this group is relative to those who did proceed with investments in Vietnam.

A second important note is that on every key investment factor, the share of businesses selecting Vietnam as superior is far higher when FIEs are asked to compare Vietnam to its chief regional rivals rather than to the investors' home country. Since most investors in Vietnam hail from the relatively developed countries of Japan, South Korea, Singapore, Taiwan, United States, and Europe, these results make sense. Certainly one would expect Vietnam's infrastructure and public services to look far worse in comparison to OECD home countries. For home countries, only 9% said Vietnam's infrastructure was superior and only 21% claimed that Vietnam's public services were better. When compared to emerging market rivals, Vietnam had higher selection rates (37% for infrastructure and 32% public services).

Comparing the two groups, however, does provide us with a unique sense of the bias observed in global comparisons such as the *Global Competitiveness Index* survey or *World Bank Investment*

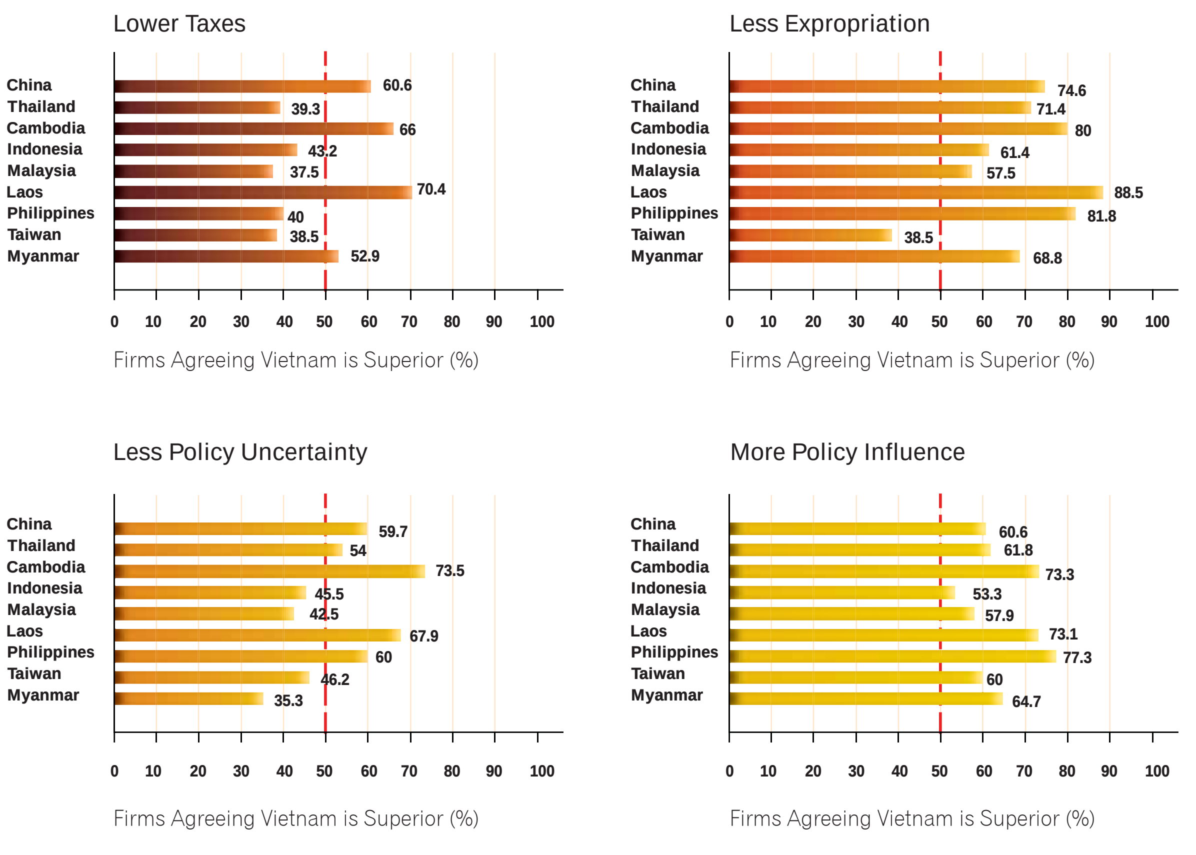
Climate Analyses. In these comparisons, investors rank their host country on Likert scales that do not specify the exact comparator. This leaves room for confusion, as to whom exactly the respondent has in mind when answering the question. Moreover, we know that investors do consider the high end of the scale to be developed countries, which leaves less room to distinguish the variation within emerging and frontier markets.

" *Vietnam fared well on: expropriation risk (64% preferred Vietnam); policy stability (60%); influence of FIEs over policies that affect their business (59%); and reasonably well on the burden of tax rates (52%) relative to competitors.* "

By comparison, the PCI-FDI survey provides a more precise look at how Vietnam actually stacks up to its chief regional rivals. Looking specifically at the aggregate score for alternative locations in Panel 1, Vietnam fared well on: expropriation risk (64% preferred Vietnam); policy stability (60%); influence of FIEs over policies that affect their business (59%); and reasonably well on the burden of tax rates (52%) relative to competitors.

Figure 2.2 takes this analysis a little bit deeper, by studying Vietnam relative to its main rivals in four strengths. Seeing the chart this way, we see some important divergence. On expropriation for instance, investors are far more confident about their investments in Vietnam than competitors. For instance, 75% argued that Vietnam has less expropriation risk than China and surprisingly, 71% ranked Vietnam ahead of Thailand, perhaps reflecting concerns about political risk. The lone exception was Taiwan, where only 38% of FIEs ranked Vietnam as having stronger property rights.

FIGURE 2.2 **Strengths of Vietnam Relative to Competitor**



Policy influence, the ability of FIEs to have a say in the drafting and implementation of laws and regulations that affect their business is higher in Vietnam than any of its competitors, particularly neighboring Cambodia and Laos. This score likely reflects the strong presence of business associations, chambers of commerce, availability for online commentary on draft laws and regulations, and unique discussions like the biannual Vietnam Business Forums, which open up opportunities for direct dialogue between the foreign business community and Vietnamese government officials. In Chapter 3, we analyze the benefits of opening up participatory opportunities for firms to share their opinions on draft laws and regulations.

Policy uncertainty provides more variation. FIEs believe Vietnam has greater stability and predictability than China, Thailand, Cambodia, and Laos. On the other hand, they credit Indonesia, Malaysia, and Taiwan with less volatility than Vietnam. These findings are critical, as FIEs value the ability to predict changes in laws well into the future, allowing them to make long-term strategic plans. Moreover, investors in high-tech goods and services value policy stability even more, as it often takes them longer to be profitable and their investments have greater inherent risks. Right now, it is clear that Vietnam outperforms its competitors in low-end production, but still ranks behind the primary destinations for more sophisticated investments.

Vietnam's satisfactory performance on relative tax burden may come as a surprise to some, but the perceptions of investors lines up with the actual tax rates of Vietnam's competitors. Nevertheless, Vietnam's average Value Added Tax (VAT) of 10% and Corporate Income Tax of (23% in 2013, 25% in previous years) is in line with many their competitors. China, Indonesia, Malaysia all have average corporate tax rates of 25%. The Philippines has a slightly higher CIT of 30% and VAT 12%. On the other hand, Thailand (23%, now 18%) and Taiwan (17%) have lower tax rates, as do Singapore and Hong Kong. Thus, Vietnam sits directly in the middle. As we will see below, it is indicated that Vietnam could benefit from lowering the CIT, there by harmonizing with the leaders in the region.[16]

FIGURE 2.3 **Weaknesses of Vietnam Relative to Competitor**

[16] See KPMG (2013) for a useful tax comparison tool and PwC (2013) for a more detailed comparison.

Figure 2.3 tackles Vietnam's main weaknesses relative to its competitors. In this graph, there is again significant variation among Vietnam's rivals, but the general message is clear. Consistently, FIEs evaluate Vietnam to be significantly less attractive when it comes to corruption, regulatory burdens, quality of public services (such as education and health care), and the quality and reliability of infrastructure. On infrastructure, investors place Vietnam in roughly the same neighborhood as its neighbors Cambodia and Laos. But surprisingly, Vietnam appears to rank worse than them when it comes to corruption and the regulatory burden.

These findings are broadly consistent with Vietnam's performance in the most recent ***Global Competitiveness Index*** rankings where it ranked 98 out of 148 countries in the Institutions Pillar, and recorded the largest drop of any of the 12 pillars. On institutions specifically, Vietnam ranked 116th on corruption and 106th on regulatory burden.[17]

On all these issues, Taiwan and Malaysia appear as standout alternatives to Vietnam, which is again illustrative. Both economies are far more likely to attract the high technology and value added investors that Vietnamese policy-makers desire.

This can be seen more clearly in Table 2.3, where we study a few selected sectors. Notice how less sophisticated sectors, such as agriculture/aquaculture and wood products are far more satisfied with Vietnamese performance on the weaker factors than complex and sophisticated sectors, such as manufacturing of machinery and electronics. Similarly, high-tech services also report deep dissatisfaction with public service delivery and infrastructure.

[17] Schwab and Sala-i-Martín (2013).

TABLE 2.3 **Business Environment by Selected Sector**

		Vietnamese Strengths				Vietnameses Weaknesses			
ISIC (4)	**Sector**	**I face fewer policy uncertainties**	**I face lower tax rates**	**I face lower risks of expropriation**	**I play a more active role in policymaking**	**I face less corruption**	**Infrastructure is better**	**Public service delivery is better**	**I face fewer regulatory constraints**
A	Agriculture, Aquaculture	85.7%	85.7%	71.4%	100.0%	100.0%	71.4%	100.0%	85.7%
C16	Man. Wood Products	50.0%	57.1%	46.7%	82.4%	68.8%	40.0%	53.3%	80.0%
C22	Man. Rubber & Plastic	62.7%	46.9%	65.3%	50.0%	31.3%	36.7%	34.7%	45.1%
C28	Man. Machinery	50.0%	45.0%	52.4%	57.9%	19.0%	40.0%	15.0%	15.8%
C27	Man. Electronics	54.5%	55.0%	66.7%	52.4%	33.3%	40.9%	33.3%	40.9%
J	Information & Communication	53.6%	58.9%	57.9%	50.0%	30.4%	34.5%	24.1%	31.6%
K	Finance and Insurance	62.5%	37.5%	75.0%	88.9%	62.5%	25.0%	14.3%	50.0%
M	Professional, Scientific	50.0%	35.6%	50.0%	48.9%	28.6%	23.4%	19.1%	35.4%

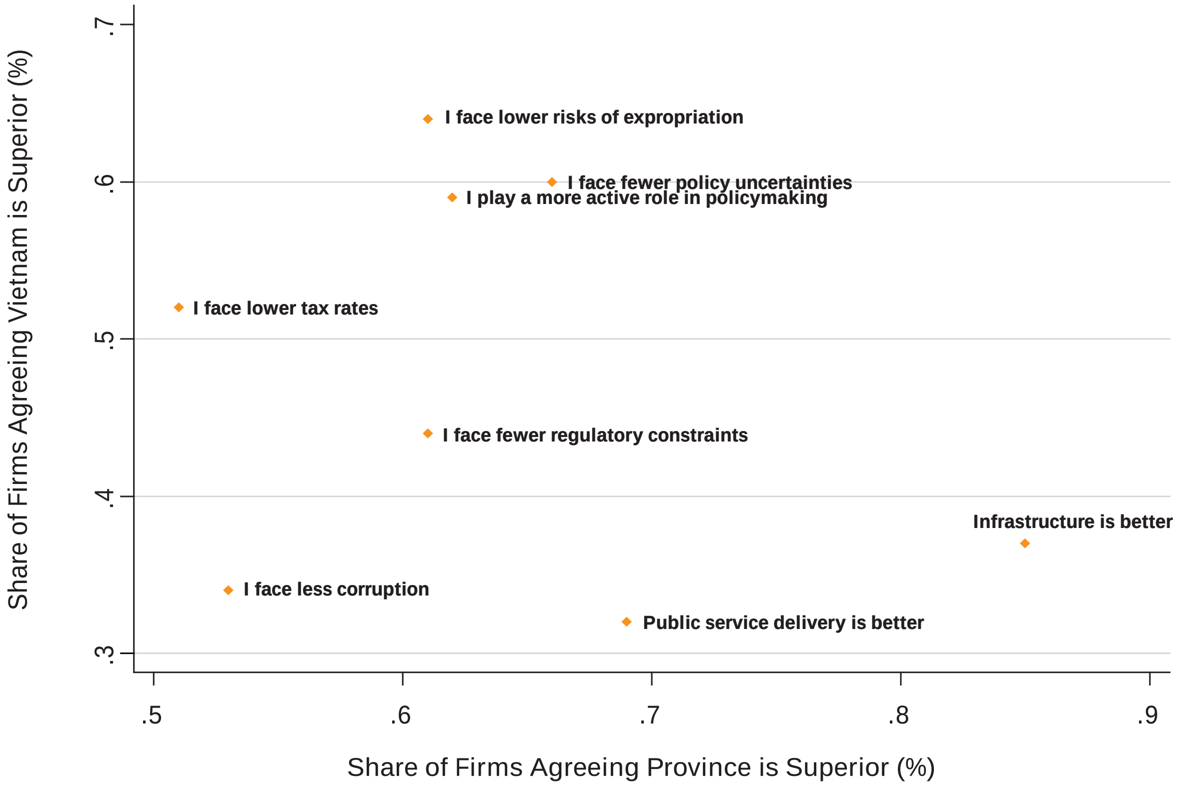
2.4 PROVINCIAL ENVIRONMENTS FOR FDI

In the third panel of Table 2.2, we asked FIEs to reflect on the provinces in which they chose to invest compared to the others they considered. The first thing to notice is that provincial scores are quite a bit higher than the national comparisons, implying that a larger share of firms believe their provincial selection was superior to the alternative. From this, we can conclude that:1) FIEs in provinces tend to be in general agreement that they made the right choice; and 2) FIEs did not experience the same quandary regarding trade-offs between factors in their selection process. They generally tended to rank their provincial choices as superior on multiple criteria.

> " *When it comes to provincial choices, however, they prioritized infrastructure and public services in their subnational location decisions.* "

A second remarkable feature of the provincial choices is how they represent the inversion of the national selection process. This can be seen more clearly in Figure 2.4. For instance, businesses selected Vietnam in spite of misgivings about its infrastructure and services compared to the alternative. When it comes to provincial choices, however, they prioritized infrastructure and public services in their subnational location decisions. The same pattern holds, albeit more tentatively, for regulatory constraints – weighted low in national choices and mid-range in provincial selections. At the other end of the scale, tax rates with an agreement rate of 50%, apparently played the smallest role in the selection of a province for investment. This weakly negative relationship (0.3) between provincial and national agreement lends support to the idea that businesses compensate for their national trade-offs with their subnational location decisions. That is, if a business knows that the major obstacle it faces in Vietnam is infrastructure, it is likely to select the very best infrastructure it can identify within the country, when choosing the location, in order to mitigate the danger.

FIGURE 2.4 National Preference versus Provincial Preferences



Using provincial agreement rates, we constructed Table 2.4, which evaluates how investors in each of the major FDI-recipient provinces rank their experience compared to the alternative locations they considered. As we noted above, there is a strong correlation among the eight different factors. FIEs that believe their province is better on one category, generally also rank it highly on others. The one exception is infrastructure which is only weakly correlated with the seven other determinants.

While fine-grained distinctions are not statistically possible, one can distinguish three general groups: 1) Provinces in which investors are generally satisfied with their choices and therefore have average agreement rates above 70%; 2) Provinces in which foreign investors have significant misgiving about one or two measures (usually corruption and regulatory burden) and therefore have lower average scores, ranging from 57% to 67%; and 3) Provinces where there is tremendous dissatisfaction relative to the alternatives, and therefore record average agreements rates of around 50% of less. Ha Noi stands out for a particularly troublesome environment in these head-to-head ratings.

TABLE 2.4 Competitiveness of Province versus Alternative

Province	N	I face less corruption	I face fewer regulatory constraints	I face lower tax rates	I face lower risks of expropriation	I face fewer policy uncertainties	Infrastructure is better	Public service delivery is better	I play a more active role in policymaking	Average
Hai Duong	42	72.7%	72.7%	68.2%	82.6%	81.8%	96.2%	69.6%	72.7%	77.1%
Bac Ninh	48	69.0%	69.2%	53.8%	83.3%	80.0%	97.1%	88.0%	76.0%	77.1%
Tay Ninh	49	68.8%	71.9%	87.1%	82.8%	83.3%	80.0%	67.9%	74.1%	77.0%
Long An	53	69.7%	72.7%	69.0%	67.7%	76.5%	76.5%	81.3%	81.3%	74.3%
Binh Duong	226	69.4%	72.8%	59.3%	70.5%	65.2%	84.4%	80.5%	74.8%	72.1%
HCMC	385	55.2%	73.9%	58.4%	70.7%	77.9%	92.6%	70.7%	65.8%	70.6%
Dong Nai	192	75.6%	72.0%	68.6%	71.8%	62.6%	81.3%	67.9%	62.3%	70.3%
Vinh Phuc	46	58.8%	55.9%	60.6%	57.6%	78.8%	84.2%	65.7%	75.8%	67.2%
Hai Phong	80	49.2%	51.6%	50.0%	59.6%	66.7%	80.6%	66.1%	66.1%	61.2%
BRVT	45	43.5%	50.0%	50.0%	47.4%	63.6%	89.2%	71.9%	63.6%	59.9%
Hung Yen	52	50.0%	64.1%	42.1%	56.4%	59.0%	80.5%	56.4%	52.5%	57.6%
Da Nang	53	46.7%	44.2%	24.4%	51.1%	47.6%	87.0%	64.4%	54.5%	52.5%
Ha Noi	338	25.6%	33.0%	25.1%	35.7%	50.0%	77.5%	62.2%	42.1%	43.9%

2.5 SPECIAL ANALYSIS OF TRANSFER MISPRICING

The subject of "transfer mispricing" has become a heated and sensitive topic over the past two years internationally, leading organizations like the Organization for Economic Cooperation and Development (OECD) and the government of the United Kingdom to open special investigations into the activity.[18] The subject has led to fierce debates between companies and states around the world. Governments worry about protecting their tax base in order to provide public services to their citizens. Companies worry that high and unpredictable tax policies damage their business prospects and ultimately hurt the economic welfare of the countries in which they are investing. Vietnam is not an outlier in either the scale of the activity or the level of controversy—this is a global phenomenon. In this chapter, we step back from the heated rhetoric of corporations and tax authorities for a moment to evaluate the practice analytically.

Let us be clear at the onset, there is nothing illegal, unethical, or unscrupulous about the normal practice of transfer pricing when it is done according to the legal rules of the host country.

It may be helpful to begin with some definitions. At its most basic, ***"Transfer Pricing"*** is just the act of assigning internal prices for goods and services that are sold within a company and between subsidiaries of the same company. This is a normal practice that has been a part of business since the invention of the firm.[19]

In more common usage, "transfer pricing" is defined as a profit allocation method used to calculate and attribute MNCs net profit (or loss) before tax in countries where it does business. Activities that fall within this rubric often include: 1) the setting of prices among divisions within an enterprise; and 2) charges for goods and services between controlled (or related) legal entities within an enterprise, including branches, subsidiaries, and, in some cases, companies sharing members of a board of directors.[20]

In principle, a transfer price should match either what the seller would charge an independent, external customer, or what the buyer would pay an independent, external supplier. These benchmark transactions are known as ***"arm's length"*** prices. Where an "arm's length" price can be determined (e.g. commodities), the identification of accurate transfer pricing is easy to verify. In some cases, accurate transfer prices are harder to identify, because the good or service in question is an intangible asset, such as a franchise license, intellectual property, or proprietary technology, for which there are no arm's length prices available.[21] These cases are more complicated, but nonetheless entirely legal and standard operating procedure for modern MNCs.

Transfer prices become a concern when they are incorrectly applied to lower profits in a division of an enterprise that is located in a country that levies high taxes, and raise profits in a country that levies no or low taxes, such as a tax haven.[22] This activity, known as ***"Transfer Mispricing",*** can be problematic when it deprives host countries of legal tax revenue. Such activities include over-

18 OECD 2009; Mirlees et al. 2012.
19 Coase 1937.
20 OECD 2009
21 Neighbor 2002.
22 OECD 2007

charging for equipment and inputs, over-valuing internal consulting services, payments for brands and licenses that are not charged to similar subsidiaries in other countries, and borrowing from subsidiaries in low tax environments (often tax havens). These activities place countries like Vietnam in the difficult position of protecting their tax base, while maintaining a hospitable environment for foreign investors.

Transfer mispricing is the most common form of a set of techniques known as ***"Profit Shifting,"*** which is defined as "The manipulation of costs and revenues within an MNC across taxing jurisdictions (countries) so as to record profits where they will be taxed at the lowest rate."[23] Transfer mispricing is not the only profit-shifting technique, but it is by far the most common, so the two terms are often used as synonyms in academic and legal discussions of the issue.

In the research below, our primary objective is to determine the scale and drivers of "transfer mispricing" in Vietnam, in order to help the country identify potential policy solutions. We have no intention of casting aspersions on any particular actor or industry. We only seek to identify common patterns that can be used to identify a solution.

The Situation in Vietnam

In 2012, the General Department of Taxation (GDT) issued a report declaring that 57% of the 5,500 FIES it investigated (representing 60% of total foreign operations), reported net losses between 2010 and 2011. Pushing deeper in October 2012, the GDT announced an extensive audit in several provinces, finding 122 FIEs in violation of transfer mispricing rules according to the GDT's interpretation of Circular 66/2010/TT-BTC (Circular 66), requesting additional tax payments of over $10 million. On the list were several iconic companies, including some of the world's biggest MNCs and famous brands.[24]

Vietnamese government officials have been consistent in their claims. They believe transfer mispricing is taking place and that is damaging the Vietnamese economy by depriving it of revenue that could be channeled to improve exactly the issues that FIEs consider to be Vietnamese biggest weaknesses: infrastructure, education, and other forms of public service delivery. FIEs, they insist, cannot have it both ways, complaining about adequate facilities while depriving the government of the resources that they need to achieve those goals.[25]

Background

The theoretical foundation of transfer pricing traces all the way back to the classic ***Nature of the Firm*** by Nobel laureate Ronald Coase (1937), who famously argued that forming firms has advantages over creating a product entirely through market-based transactions, even under conditions of perfect competition. The key insight of Coase was that doing business solely through the market would

23 http://www.businessdictionary.com/
24 The highest level of derision was reserved for Korean Keangnam Vina (a 1.22 trillion VND ($60 million) operation) and Hua Lon, a Malaysian-Taiwanese-British Virgin Island joint venture, which both were cited for over $70 million in transfer mispricing diversions. Famously, the GDT announced that Hua Lon declared a value of $16 million for a used production line that, if sold to a third-party, would most likely be priced at $400,000 (Pham 2013b).
25 Thanh 2013.

require enormous transaction costs as firms would need to acquire information for price discovery for all inputs (e.g. goods, services, labor), agree to contractual terms for all those inputs, and re-negotiate all those contracts when prices and conditions change. It was far easier and cost effective, argued Coase, to form a firm and thereby bring all of those activities in-house. Firms could assign internal prices for products and activities for accounting purposes, reducing the time and energy wasted on information acquisitions and negotiations. In short, transfer pricing is fundamental to standard business practices and accounting. There is nothing illegal about assigning internal prices for products that do not take place through "arm's-length" transactions.

What was true in 1937 has become far more relevant today in era of rapidly expanding globalization. Five forces have combined to generate what *Pricewaterhouse Cooper (2013)*, one of the largest global accountancies, has called the "Perfect Storm" for transfer pricing.

First, rapidly expanding international trade has increased the magnitude and diversity of products available to companies producing goods and services around the world. Second, the expansion of FDI, particularly the surge of FDI into developing countries in the past two decades has expanded the number of foreign subsidiaries working in any given host country, forcing host countries to deal with different accounting practices, corporate cultures, and the unique home-country tax jurisdictions of their new guests. Third, the rise of Multinational Corporations (MNCs) and the mainstreaming of international production chains that leads to components of products being developed in multiple countries around the world, means that MNCs are now operating under a wide variety of tax codes that provide very different opportunities and risks. Today, more products reach customers through production by MNC affiliates than through direct exports.[26] Fourth, the necessity of these MNCs to return the highest value to their shareholders means that reducing their tax obligations is a critical component of their business models. MNCs therefore invest heavily in specialized lawyers and accountants to help them lower their ultimate tax burden.

Finally, the information age has increased the value of intellectual property and technology. A large portion of the value of a product or service is the specialized technical knowledge, management, and creative ideas that are brought into the product's design, testing, and production. Because of the critical value of intellectual property and the ease with which it can be stolen, many MNC, and even smaller FIEs, choose to protect it by employing it in only in-house transactions.[27] The use of proprietary knowledge, techniques, and intellectual property as strategic assets means that there is not a publically available market for these activities. True price discovery for intangible assets is impossible, because arms' length transactions simply do not exist for most these goods and activities.

These five forces have combined to make transfer pricing an inevitable fact of life for national policy-makers. Rather than doing battle with well-resourced MNCs in courts or the media, a more fruitful strategy for leaders of emerging economies like Vietnam is to figure out what they can do to change tax policy and implementation that will allow them to retain as much revenue within their jurisdictions for public services.

26 UNCTAD 2013, Stern 2012
27 PwC 2013

Vietnamese authorities have been proactive in their responses, devising a framework for use by local branches of the tax authorities to identify companies that are transfer mispricing or "profit shifting" requiring that investors follow Circular 66 in providing contemporaneous documentation and submitting annual declaration forms. Companies that are considered by GDT to be in breach have been audited.

The GVN is wrestling with these issues in a draft circular on Advancing Pricing Arrangement ("APA") whereby the government and investors negotiate and contract on the specific transfer (mis)pricing methodology that will be employed ahead of time. This provides transparency about how a company will be scrutinized and allows it to plan accordingly without fear of surprises. In some cases, the sides may even agree on a minimum profit level on which to base CIT valuations to avoid scrutiny and compliance debates over the agreed upon period. Although there is skepticism about its utility, a program is being piloted with ***Samsung*** and a few other investors agreeing to declare their costs, prices, and projected profits for the next three years.[28]

Audits and APAs may help introduce greater transparency and trust into this issue, but they are often quite burdensome for tax authorities and a civil service that is already stretched to the limits of their capacity, as they require giving personalized attention to each of the 7,700 FIEs that currently operate in its borders – to say nothing of the numerous domestic Vietnamese companies that now do business overseas and are becoming more sophisticated about tax policy in their own right. International pricing models for MNCs are extremely nuanced, technical, and precise. Local tax authorities can simply not keep up with all of the new innovations used by companies in what *The Economist* (2014) has called "a series of cat and mouse games." Sir James Mirrlees, a Nobel Laureate in economics, studied the practices in the United Kingdom, and summarized the current practice as posing "very high compliance costs for international companies, and very high administration costs for tax authorities" (Mirrlees et al., 2012). Consequently, the Vietnamese GDT needs a set of solutions that can be applied generally and will reduce income shifting without over-burdening its current inspection teams.

One technical solution jumps immediately out of the documentation by transfer pricing experts who have looked at Vietnam. Vietnam has an overly generous interpretation of the term "related party," allowing FIEs to book a wide range of activities as "related" transactions and therefore use internal pricing determinations over arm's-length calculations. PwC puts it this way, "The extension of the related party definition under Circular 66 has rendered many parties, which would otherwise be considered as unrelated, to be classified as related parties for Vietnam transfer purposes."[29] For instance, Vietnam only requires that a business partner provide capital participation of 20% to be considered a related party, thereby including a whole range of normal business transactions under the *"related party"* label. Similarly extraordinary is the fact that an FIE can consider a vendor to be a related party if 50% of its costs production materials or intellectual property accrue to that organization. Both of these extensions generate greater complexity than necessary for assessing the true price of transactions. Changing them would put Vietnam more in line with international norms.

28 Dezan Shira 2013.
29 PwC 2013: 853

Nevertheless, there is still more that Vietnam can do. Repeatedly, FIEs in Vietnam cite the volatility of tax laws in their justifications for transfer behavior. The argument is straightforward and simple – lack of transparency and highly unpredictable tax changes impose significant risk to operations in the country. Some have even gone as far as to call this "soft expropriation" meaning a seizure of capital through legal technicalities rather than a direct appropriation.[30] To combat this activity and to provide adequate cash flow for their business activities in the country, companies have an incentive to smooth over the volatility through transfer mispricing. This allows companies to project a stable tax burden for the foreseeable future. APA provides one solution to this problem for select firms. A more general solution, advocated by FIEs, would be for Vietnamese policy-makers to improve the creation of tax policy, so that it is more transparent and predictable. This generates the following, testable hypothesis:

H1: Improvements in predictability of tax laws will reduce the share for firms engaging in transfer mispricing.

A recent report to the Vietnam Business Forum (VBF) by representatives of the auto industry highlighted the challenges they have faced with Vietnamese tax regime. While the overall tax burden was cited, the industrial representatives were far more concerned about the complexity and frequent oscillations. A few key examples include: 1) Continuous changes in import duties for components (as well as changes in rules about royalties for proprietary technology); 2) Changes in the vehicle registration tax, and different application to types of vehicles, have reduced market sales; 3) Complex and changing rules on origin and hybrid vehicles change the domestic tax rate and affect the predictability of local sales; 4) The call for publication of a clear road map on automobile tax policy until 2018. Specifically, the investors specify their hypothesis succinctly: "Further tax and policy stability will fortify investor confidence and growth in the industry. All of this will lead to increased customer choice and development of the country."[31]

This hypothesis carries important policy implications for Vietnamese policy-makers – develop a stable, predictable tax regime and companies will keep their profits in the country fuelling vital public and social services.

Measurement

Before taking the word of firms at face value, however, it is important to subject claim to rigorous empirical testing. Doing this requires accurate measurement of the scale of transfer mispricing currently taking place in Vietnam – no trivial task.

Accurately measuring the scale of transfer mispricing is extremely difficult. Methods exist for the reporting and auditing of transfer mispricing on individual basis.[32] To perform these techniques,

30 Marshall and Stone. 2012.
31 Automotive Working Group. 2013.
32 These include: 1) Comparable Uncontrolled Pricing (CUP), where a similar arms-length transaction price is found among unrelated parties and applied to the specific firm transaction under investigation; 2) A Cost-Plus Method (CPM), which compares the mark-up between audited and comparison parties, thereby allowing indirect costs to be included in the pricing (currently Vietnam's preferred technique on most transactions); 3) The Re-Sale Price Method (RPM), where the auditor compares the gross profit margins from sales from the company under investigation to third-party companies who also purchased the same component or product; 4) Transaction Net Margin (TNM) which assess the operating margin of the audited firm; and 5) The Profit-Split Method, which looks at the division of profits between related parties.

however, precise and fine-grained access to firms' financial accounts is needed. In most cases, access is also needed to the accounts of related parties, third-parties, and comparators, who have no reason to provide it to non-government researchers. Obtaining this level of detail is made doubly difficult by the fact that auditors are generally trying to assess accurate pricing on intellectual property and technical services for which there is little comparative information. Moreover, many companies regard pricing on these activities to be highly sensitive, affecting their strategic planning, and therefore guard them as critical industrial secrets.

Even if such access is available on an individual level, it is impossible for large-n statistical analysis, where data on thousands of firms must be processed. Because answering honestly about transfer mispricing may force respondents to reveal information to their competitors or place them in danger of reprisals from Vietnamese authorities, it is not clear that accurate information can be obtained by researchers. In many cases, respondents may choose not to answer or answer inaccurately, leading to biased conclusions by analysts.

Consequently, economists have struggled to accurately measure the scale of transfer mispricing globally. Most evidence of income shifting has been obtained indirectly by looking at firm profitability and country-level measures of tax burden. For instance, Grubert and Mutti (1991) and Hines and Rice (1994) use country-level data to identify a negative relationship between the reported profitability of the foreign affiliates of U.S. multinational firms and the corporate income tax rates of their host countries.[33] Until recently almost all of the work was done on United States companies which had the most accurate data on MNCs. Chang et al. (2011), however, recently studied the behavior of MNCs in China, finding that subsidiaries shifted profits to and from China depending on corporate tax rates and that the magnitudes of tax-motivated income shifting activities resulted from variation in the firms' level of fixed asset investment, intangible assets (e.g. proprietary technology), and debt ratio.

To try to address these problems of measurement, we use a cutting edge technique known as the Unmatched Count Technique (UCT), but is more informally known as the LIST question.[34] List questions are extremely easy to administer, as a respondent is simply presented with a list of activities and must only answer how many of the activities they engaged in. They are not obligated to admit to engaging in a sensitive activity in any way. As a result, the respondent can reveal critical information without fear.

Couts and Jann (2011) have shown in a series of experimental trials that UCT outperforms all other techniques at eliciting sensitive information and maintaining the comfort level of respondents. The trick to the UCT approach is that the sample of respondents is randomly divided into two groups that are equal on all observable characteristics. One group of respondents is provided with a list of relatively infrequent, but not impossible activities, which are not sensitive in any way. The second group, however, receives an additional item, randomly placed in the list. This additional item is the

33 Harris, Morck, Slemrod, and Yeung (1993) similarly find that U.S. multinational firms' U.S. tax liabilities are relatively lower when they have subsidiaries in tax havens. Desai et al. (2004) examine the capital structure of foreign affiliates and internal capital markets of U.S. multinational firms, finding 10% higher local tax rates to be associated with 2.8% higher debt/asset ratios and that internal debt from parent firm is particularly sensitive to taxes in comparison to external debt.

34 See Couts and Jann 2011 and Blair and Imai 2012. Previous PCI reports and UNDP-PAPI analyses about corruption have also employed this type of survey experiment.

sensitive activity. The difference in means between the two groups is the percentage of respondents engaging in the sensitive activity. [35]

The PCI-FDI Measure of Transfer Mispricing

The specific PCI question for transfer mispricing was embedded in a general module on tax policy in Vietnam. Question E10 is shown in the box below. Notice that a randomly selected group of firms received the control survey (Form A), which contained only three items, implying a range of activities between zero and three. A second randomly selected group, statistically equivalent on all dimensions, received Form B, which contained the sensitive item that is highlighted in italics, *"Raised the price of internal purchases of goods and services to lower reported profits."*

The first thing to notice is that we specifically highlight the sensitive activity of transfer mispricing. Respondents answering yes to this question should not be confused about whether we are asking basic questions about their normal accounting and pricing practices. This is not about whether firms are engaging in normal practices of internal pricing for intermediate goods and technical services that fall under the rubric of standard transfer pricing. The question specifically asks whether they raised internal prices to lower their reported profitability in Vietnam, in order to lower their tax liability.

For some firms, such profit-shifting is not illegal and not considered to be sensitive at all. It is a normal part of business for franchisers to raise the price they pay for licenses of brand services in order to shift their profits overseas. These firms can answer the question directly without fear of reprisals. For other firms, this is an extremely sensitive issue, as they might be afraid that an honest answer could be used against them. These respondents needed to have their identities shielded in order to answer honestly.

It was also critical to ensure that all treatment respondents were provided with a cushion, so that they felt it would be impossible to identify that they had personally engaged in transfer mispricing. Three problems could potentially arise. First, respondents in the treatment group might believe that the non-sensitive responses are too rare, so that by answering one item they would be essentially admitting to transfer mispricing. Alternatively, respondents might believe that the non-sensitive activities are too common, so that they are forced to answer four items, thereby revealing their complicity. Ideally, therefore, question designers must choose the non-sensitive items, so that it is unlikely that respondents in the control group get pushed toward the floor (zero activities) or ceiling (three activities). Our survey met this critical test – 65% of the control respondents ticked one or two activities, and only 1.8% answered all three items. Finally, selection of control items cannot be positively correlated with each other, otherwise they combine to generate the equivalent of a ceiling effect. Our control items were specifically chosen, so that they were uncorrelated with each other by design (i.e. firms hiring international accountants were unlikely to use domestic ones).

[35] It is important to remember that the mean of a dichotomous variable can also be read as a percentage. For example, in a question where a respondent was asked to list their gender and female was coded as 1, while male was coded as 0, the mean of that variable is the percentage of females in the sample. Because there is a one item difference between the two groups, the same rule applies.

A second choice in the design of the question means that our results are best thought of as lower bound estimates of transfer mispricing. Some firms may not engage in the practice directly, but instead rely on external, hired hands to provide the accounting strategies. As a result, they may not have full information about all of the accounting that goes is included in their Vietnamese tax return. Items one and two in the question below ensured that firms in both the control and treatment group saw these responses, so that their usage would raise the average score of both groups, but would not affect the difference in means between the two groups.

E10. Please look at the following list of activities that foreign firms currently use to lower their tax burden in Vietnam.

- ☐ Hired an international law firm to advise on tax policy
- ☐ Hired a domestic law firm or consultancy to advise on tax policy
- ☐ Increased purchases from Vietnamese vendors
- ☐ *Raised the price of internal purchases of goods and services to lower reported profits [FORM B]*

Please do not answer about any one of these activities specifically, we are only interested in the TOTAL NUMBER you may have employed. How many of the above activities did you engage before filing your most recent tax payment?

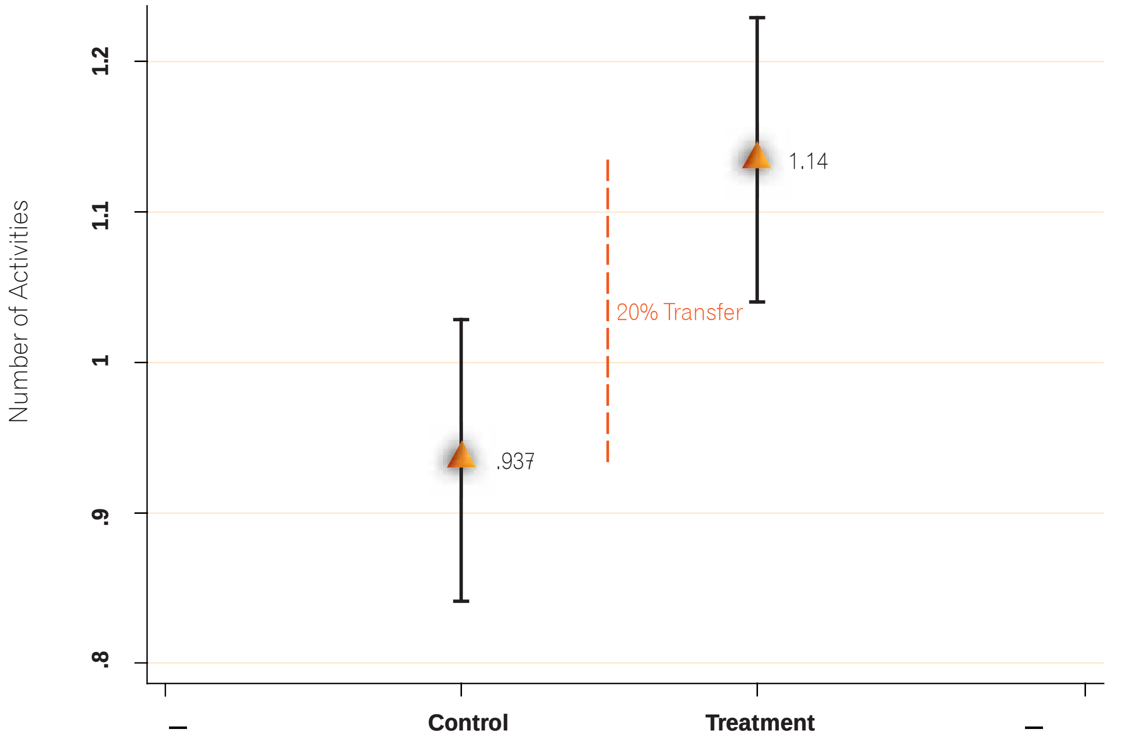
NUMBER OF ACTIVITIES: ☐ 0 ☐ 1 ☐ 2 ☐ 3 ☐ 4

" The difference between the means is 0.199 or 20%, indicating that 20% of respondents engaged in transfer mispricing in the past year. "

Figure 2.5 demonstrates the results for the UCT questions employed in the PCI survey to measure the national scale of transfer mispricing. Respondents who received Form B (the treatment) answered that they took part in 1.14 activities on average. Respondents who received Form A (the control) claim they took part in .937 activities. The difference between the means is 0.199 or 20%, indicating that 20% of respondents engaged in transfer mispricing in the past year. As the 95% confidence intervals plotted around the mean score reveal, these means are significantly different. That is, the difference in means could not have occurred by coincidence. Repeated random samples would yield significantly sizable results, ranging from a minimum of 10% to a maximum of 30%.[36]

[36] A t-test reveals a t-statistic of 2.3, and a p-value of 0.01. In short, this difference is statistically significant at the 99% level.

FIGURE 2.5 | Estimated Transfer Pricing in Vietnam



Before proceeding to a test of our hypothesis, it is useful to subject our measure to a basic logic check.

It should be true that self-reported performance should be positively correlated with transfer mispricing. The expectation is that firms engage in transfer mispricing to shift profits to low-tax regimes. This means that their official tax statements will yield losses, but firm managers will still likely claim credit for success in their internal reporting, especially in subsidiaries of MNCs. If the combination of our UCT and self-reported profit questions are revealing new information about transfer mispricing, we should find that high-performing firms are more likely to engage in the practice. Firms that are truly running losses have no need to engage in transfer mispricing.

Table 2.5 reveals the results of this analysis. Indeed, we find that 65% of extremely profitable firms (greater than 20% margins) admit to engaging in the practice. Similarly, 44% of highly profitable firms, 12% of moderately profitable firms, and 9% of positive, but low margin operations also engage in the practice. In general, loss-making firms do not employ income shifting techniques with one exception. About 30% of firms with small losses (between 0 and 5%) admit to the practice. This is interesting, because this most likely captures the highly sophisticated firms who use transfer mispricing to push themselves to just below the margin of profitability that exempts them from CIT payments.

TABLE 2.5 **Estimated Share of Firms Engaged in Transfer Mispricing (by Performance)**

	Performance Category	N	Share of Firms	SE	T-Value	P-Value	Low Estimate	High Estimate
			Estimated Transfer Mispricing (%)					
8	More than 20% profit margin	39	65.1%***	10.1%	6.4	0.00	48.9%	81.3%
7	10-20% profit margin	105	44.5%***	6.9%	6.4	0.00	33.5%	55.5%
6	5-10% profit margin	262	12.3%	9.7%	1.3	0.23	-3.2%	27.8%
5	0-5% profit margin	455	9.1%*	4.8%	1.9	0.08	1.4%	16.8%
4	Broke even	163	19.7%	15.2%	1.3	0.22	-4.6%	44.0%
3	5-0% loss	176	30.9%	17.4%	1.8	0.10	3.1%	58.7%
2	10%-5% revenue loss	76	-2.1%*	24.6%	-0.1	0.93	-41.5%	37.3%
1	Loss of 10% revenue or greater	68	-0.3%	20.4%	0.0	0.99	-32.9%	32.3%

*** p<0.01, ** p<0.05, * p<0.1

Disaggregated Analysis

The previous section should provide us with comfort in the ability of our survey instrument to accurately estimate transfer mispricing, and that those estimates are in line with basic intuition about how and when such activity takes place. In this section, we apply the technique within categories of firms to identify whether specific patterns can be observed at the country and industrial sector level.

Table 2.6 explores whether firms from different home countries or regions behave differently in Vietnam when it comes to profit-shifting. The analysis only considers countries or regions with which we have a sizable enough sample of FIEs to accurately employ a UCT. Firms are grouped within countries, but also within regions (Europe & Asia) to see if there are specific cultural or historical traits that may be responsible. We also analyze the impact of whether a country is a member of the Organization of Economic Cooperation and Development (OECD) to identify whether level of economic development may be responsible.

TABLE 2.6 **Estimated Share of Firms Engaged in Transfer Mispricing (by Home Country/Region)**

Region/Country	N	Estimated Transfer Pricing (%)	SE	T-Statistic Value	P-Value	Low Estimate	High Estimate
France	35	62.3%	11.2%		0.00	44.4%	80.2%
Hong Kong	56	40.1%	14.5%	5.57	0.02	16.9%	63.3%
Korea	295	32.4%	15.6%	2.77	0.06	7.4%	57.4%
Asia	1301	22.2%	6.8%	2.08	0.01	11.3%	33.1%
OECD	839	17.7%	4.8%	3.25	0.00	10.0%	25.4%
Japan	313	11.9%	6.7%	3.67	0.10	1.2%	22.6%
Europe	141	7.6%	2.3%	1.78	0.01	3.9%	11.3%
Southeast Asia	212	9.2%	6.5%	3.25	0.19	-1.2%	19.6%
Taiwan	348	26.1%	20.0%	1.41	0.22	-5.9%	58.1%
USA	64	30.3%	31.8%	1.31	0.37	-20.6%	81.2%
China	72	29.7%	51.8%	0.95	0.58	-53.2%	112.6%
Singapore	86	0.4%	13.3%	0.57	0.98	-20.9%	21.7%
				0.03			

Shaded area indicates that estimated transfer pricing not significantly different from zero.

The white portion of Table 2.6 lists the countries for which we can confidently estimate positive levels of transfer mispricing. The shaded region on the lower half of the graph covers the countries/regions for which cannot rule out the possibility of zero transfer mispricing, either because the sample size is too small, variance within the home country/region is too large, or because firms from that country are truly unlikely to engage in the practice.

The clear message of the table is that there is no obvious home country pattern to transfer mispricing. We can see this by studying the overlapping confidence intervals identified by the high and low estimates of transfer mispricing. Statistically, firms from Hong Kong (17% to 63%) are just as likely to admit to practicing profit-shifting as businesses from France (44% to 80%) and elsewhere in the OECD (10% to 25%).

The lack of an obvious home-country effect makes sense. Transfer mispricing likely reflects responses of individual firms to perceived threats to their business, and based on the opportunities available to them given the structure of their company (i.e. whether they possess a multi-national production chain), and the importance of intangible assets like intellectual property in their business model. Global value chains cut both ways, as they also pose additional risk for firms, exposing them to double taxation and different interpretations of tax codes across jurisdictions. These factors point to an analysis that disaggregates transfer mispricing by economic sector. We should expect businesses involved in sectors that require multi-national production and rely on intangible assets to employ transfer mispricing, regardless of where they come from.

We undertake this sector based analysis in Table 2.7, where we estimate the level of transfer mispricing in each economic sector. Once again, industries colored in white represent sectors that we can confidently report evidence of profit-shifting. Shaded sectors are those for which the estimated ranges of transfer mispricing cannot be confidently distinguished from zero.

Looking at the data this way is revealing. The industries in white do tend to comprise the sectors that are most likely to involve global production chains where inputs are imported from subsidiaries of the parent MNC. These sectors include textiles, motor vehicles, rubber and plastics, apparel, and wood products (especially now that wood material is heavily imported from neighboring Laos and Cambodia). In addition, we find strong evidence of profit-shifting among countries where intangible and hard-to-price assets are extremely important. Finance and Insurance, Information and Communications, and Motor Vehicles are all sectors with high levels of intellectual property and technical expertise. These industries reasonably rely on internal consultants and equipment for which no adequate arms-length pricing exists, leading to sincere difficulties in adequately estimating comparative costs for tax purposes.

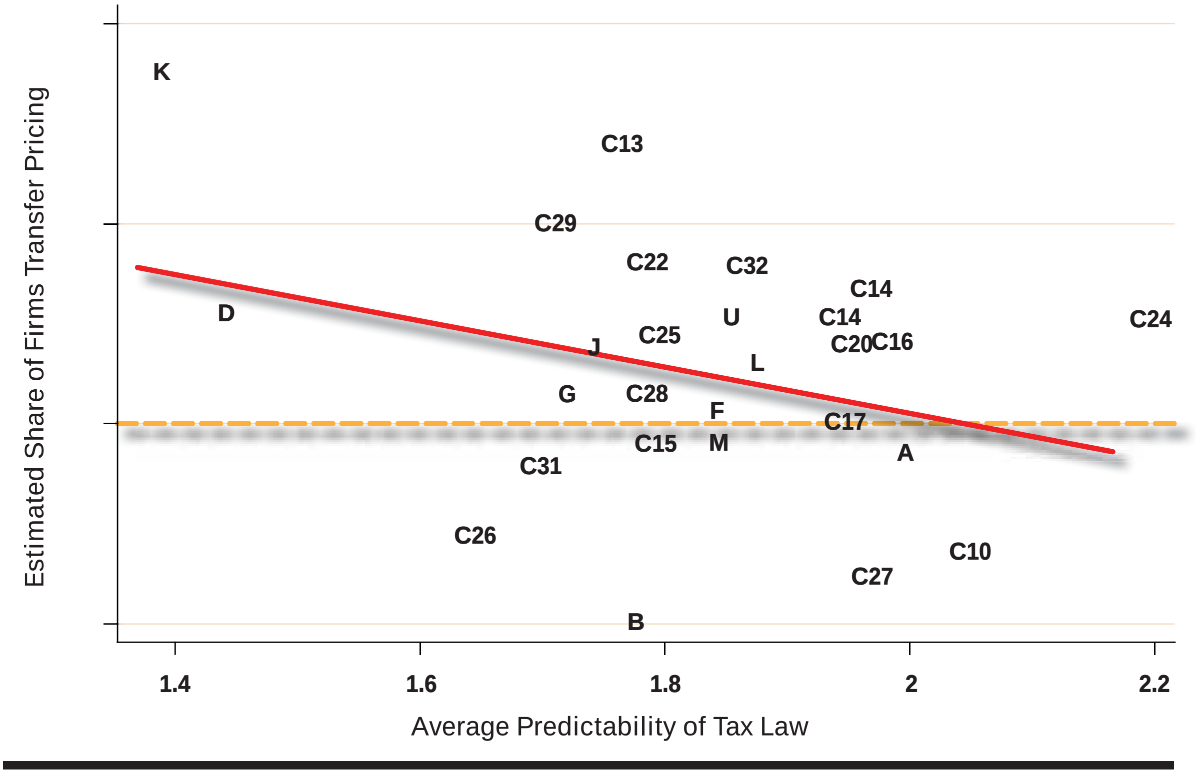
TABLE 2.7 **Estimated Share of Firms Engaged in Transfer Mispricing (by Economic Sector)**

ISIC (4)	Sector	N	Estimated Transfer Pricing (%)	SE	T-Value	P-Value	Low Estimate	High Estimate
K	Finance and Insurance	17	90.0%	30.3%	2.97	0.098	41.5%	100.0%
C13	Man. Textiles	47	70.0%	34.7%	2.02	0.069	14.5%	125.5%
C29	Man. Motor Vehicles	91	51.0%	26.3%	1.94	0.081	8.9%	93.1%
C32	Man. Other	186	41.0%	11.2%	3.66	0.003	23.1%	58.9%
C22	Man. Rubber & Plastic	88	41.0%	17.6%	2.33	0.037	12.8%	69.2%
C14	Man. Apparel	96	36.0%	5.9%	6.10	0	26.6%	45.4%
U	Other Services (Educ., Health)	149	28.3%	17.0%	1.66	0.125	1.1%	55.5%
C16	Man. Wood Products	40	23.1%	13.3%	1.74	0.126	1.8%	44.4%
J	Information & Communication	89	20.0%	8.5%	2.35	0.056	6.4%	33.6%
C24	Man. Basic Metals	37	26.9%	20.1%	1.34	0.207	-5.3%	59.1%
C25	Man. Fabricated Metal	93	23.3%	18.6%	1.25	0.234	-6.5%	53.1%
L	Real Estate	40	15.8%	17.4%	0.91	0.4	-12.0%	43.6%
C20	Man. Chemical Products	48	21.8%	24.7%	0.88	0.401	-17.7%	61.3%
G	Wholesale, Retail Trade	133	8.5%	10.2%	0.83	0.423	-7.8%	24.8%
D	Utilities (Electric & Water)	9	27.7%	43.4%	0.64	0.551	-41.7%	97.1%
C28	Man. Machinery	31	8.8%	25.6%	0.34	0.741	-32.2%	49.8%
C17	Man. Paper Products	42	1.9%	18.0%	0.11	0.919	-26.9%	30.7%
F	Construction	63	1.6%	21.1%	0.08	0.942	-32.2%	35.4%
M	Professional, Scientific	79	-1.3%	7.5%	-0.17	0.865	-13.3%	10.7%
C15	Man. Leather	41	-3.0%	16.0%	-0.19	0.857	-28.6%	22.6%
A	Agriculture, Aquaculture	9	-5.8%	25.0%	-0.23	0.823	-45.8%	34.2%
C31	Man. Furniture	35	-9.3%	33.2%	-0.28	0.787	-62.4%	43.8%
C26	Man. Computer	49	-26.8%	27.9%	-0.96	0.357	-71.4%	17.8%
C10	Man. Food & Beverage	44	-30.4%	26.9%	-1.13	0.291	-73.4%	12.6%
C27	Man. Electronics	38	-37.0%	25.4%	-1.46	0.189	-77.6%	3.6%
B	Mining	10	-50.0%	23.2%	-2.16	0.097	-87.1%	-12.9%

Finally and most importantly, many of the white sectors are those for which international businesses have publically voiced concerns about volatile tax policy in their industries, including VAT, CIT, customs duties, personal income taxes on high earners, and registration fees and licensing taxes on the end users of their products.

Figure 2.6 provides a rough and ready analysis of this relationship using PCI-FDI question E9, which asks firms to compare the predictability of tax policy in Vietnam to other countries in which they considered investing.[37] This question is rated on a three-point scale: 1) low predictability; 2) about the same; 3) high predictability. At the industry level, predictability ranges from a high average of 2.2 in the Manufacturing of Basic Metals to a low of about 1.4 in the Finance and Insurance sector.

FIGURE 2.6 **Relationship between Transfer Pricing and Predictability of Taxes**



The graph demonstrates a negative relationship between predictability and transfer mispricing. Sectors which report high levels of predictability of tax policy are significantly less likely to engage in transfer mispricing. While compelling these results should be treated as tentative. In the next section, we tackle the question using more sophisticated statistical analysis.

Analysis of Transfer Mispricing Using Regression Analysis

To examine the impact of predictability on transfer mispricing we utilize a statistical model developed by Blaire and Imai (2012).[38]

[37] Based on your experience in and perceptions of other countries, please rate the predictability of changes in Vietnamese tax policies compared to other countries at similar levels of development

[38] See Appendix for more details.

TABLE 2.8 **Multivariate LIST Estimation of Transfer Mispricing**

Dependent variable: difference between the activities reported by treatment group and predicted number of nonsensitive activities of control group.	Mean	Firm	Performance	Predict	Tax Rate 1	Tax Rate 2	Tax Burden	Combined	Country FE	Province FE	Sector FE
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(11)	(12)	(13)
Multinational Corporation=1		-0.008	-0.020	-0.045	-0.012	0.115***	-0.044	-0.035	0.161***	0.092***	0.063*
		(0.078)	(0.077)	(0.064)	(0.062)	(0.022)	(0.070)	(0.060)	(0.036)	(0.018)	(0.034)
Primary Inputs Purchased in House=1		0.130***	0.166*	0.135	0.125*	0.212***	0.147	0.083	0.290***	0.261***	0.148**
		(0.034)	(0.082)	(0.089)	(0.062)	(0.045)	(0.092)	(0.065)	(0.065)	(0.082)	(0.067)
Employment Size 2013 (1 to 8)		0.056***	0.053*	0.062**	0.035	0.025	0.058**	0.049	0.035	0.057**	0.034**
		(0.013)	(0.025)	(0.027)	(0.031)	(0.043)	(0.023)	(0.033)	(0.030)	(0.022)	(0.013)
Located in Industrial Zone=1		-0.003	0.047	0.024	0.091	0.127	0.050	0.060	0.028	0.166	0.018
		(0.141)	(0.172)	(0.181)	(0.151)	(0.081)	(0.164)	(0.138)	(0.131)	(0.103)	(0.172)
Firm Performance (1=Losses; 8 Profitable)			0.033	0.052	0.060	0.095***	0.055	0.094**	0.056*	0.025	-0.019
			(0.030)	(0.033)	(0.040)	(0.028)	(0.038)	(0.034)	(0.026)	(0.020)	(0.016)
Predicitability of Tax Law (1 to 3)				-0.279**				-0.359**	-0.460***	-0.384**	-0.322**
				(0.110)				(0.129)	(0.149)	(0.143)	(0.139)
Lower tax rates in Vietnam than Home=1					-0.365***			-0.319**	-0.363***	-0.362***	0.387***
					(0.062)			(0.108)	(0.093)	(0.088)	(0.086)
Lower tax rates in Vietnam than Competitor=1						-0.151*					
						(0.084)					
Tax Burden (Low =1 I High=3)							-0.037				
							(0.047)				
Constant	0.199**	-0.073	(0.044)	0.159	-0.104	-0.368***	-0.298	0.323	2.683***	2.411***	1.958***
	(0.073)	(0.114)	(0.044)	(0.222)	(0.100)	(0.108)	(0.176)	(0.245)	(0.143)	(0.226)	(0.468)
Country FE	No	No	No	No	No	No	No	No	Yes	Yes	Yes
Province FE	No	No	No	No	No	No	No	No	No	Yes	Yes
Sector FE	No	No	No	No	No	No	No	No	No	No	Yes
Observations	799	681	562	478	378	360	495	357	356	356	356
R-squared	0.000	0.018	0.029	0.068	0.061	0.089	0.041	0.131	0.333	0.376	0.525

Standard errors, clustered at provincial level, in parentheses; *** p<0.01, ** p<0.05, * p<0.1

In Table 2.8 we present our results using the LIST methodology from Blaire and Imai (2012) outlined in the Appendix. Note that our sample size is halved, as it is a two-stage model, where we first estimate the number of non-sensitive items in the control group, then use those estimates to calculate the scope of transfer mispricing in the treatment group on the second stage. Thus, our sample size only reflects the observations in the treatment group. In Model 1, we present a specification with no controls, showing that our results correctly recover the difference-in-means estimate presented in Figure 2.5. We find that 19.8% of firms in our sample engage in the activity.

Model 2 adds a set of key control variables to address potential omitted variable bias, as these measures may be correlated with both our dependent variable (transfer mispricing) and our key causal variable (predictability of tax policy). Our control variables include: 1) Whether a firm is a subsidiary of an MNC and therefore more likely to be involved in a global production chain; 2) Whether a firm purchases the majority of its inputs in-house and therefore has greater opportunities to engage in non-arms-length pricing; 3) Business size measured by employment, as larger businesses are thought to be more sophisticated and savvy with tax policy; 4) Whether a firm is located in an industrial zone (IZ), as IZs have special tax and customs regulations, and therefore have been thought to limit potential transfer mispricing. Model 3 adds a measure of self-reported profitability, because we have already shown that more profitable firms are the most likely to take part in profit-shifting.

Models 4 through 7 assess our survey measures of tax policy one at a time. Model 4 adds our three-point measure of tax predictability. Model 5 considers tax burden relative to the home country from Section 2.3 above, as firms with low tax rates in their home countries will be most likely to use transfer mispricing to repatriate profits. Model 6 uses the equivalent tax burden question relative to competitors, while Model 7 provides a general assessment of overall tax burden. Model 8 provides combines predictability and tax burden in the same model, while Model 9 subjects provides the most rigorous, holding constant variation within home country, location of home-country headquarters. [39]

Findings

Focusing on Model 9 with home country fixed effects to hold constant cultural and historical factors, we find that MNCs, firms that purchase inputs in-house, and profitable firms are all significantly more likely to engage in transfer mispricing than their peers. In fact, one can read the marginal impact of these factors directly off the regression table. For instance, the 0.16 next to MNCs means that subsidiaries involved in global production chains have a 16 percentage point higher probability of profit shifting than firms that do not have such connections.

The results for tax burden and predictability are striking. Unsurprisingly, firms who believe they face lower tax burdens in Vietnam than their home countries are less likely to shift profits. What is surprising is the magnitude of the effect – 36% lower than firms who perceive the tax burden in their home country to be lower. The effect of predictability is even more eye opening, holding constant other factors and the tax burden: firms that assess the Vietnamese tax system as predictable (shifting up one point on our three-point scale) in their industry have a predicted probability of transfer mispricing that is 46% less than their peers suffering from a higher level of volatile policy.

[39] Models 10 and 11 (shaded) provide robustness tests with provincial and two-digit sector FE.

Policy Implications

> *" …if they could ensure firms a predictable tax schedule in the future… those businesses are more likely to restrain from transfer mispricing … "*

The results of the transfer mispricing analysis provide clear policy solutions for Vietnamese officials. Lowering CIT to the level companies experience in their home countries will certainly reduce incentives to income shift. A lot of what is taking place appears to be companies repatriating profits to their low-tax headquarters. Nevertheless, even without drastic changes in the tax rates, if they could ensure firms a predictable tax schedule in the future, so that businesses can adequately estimate their future burden, those businesses are more likely to restrain from transfer mispricing – keeping vital revenue in the country that can be used to offset the weaknesses in public services and infrastructure that investors cite as Vietnam's most important strategic disadvantages. Considerable and frequent changes in Vietnam's policies pose expensive costs on firms, who must develop new strategies for addressing these changes. As we noted, Vietnam has already started down this path with several new circulars on transfer mispricing regulations, including the APA which provides the tax certainty that is so vital to MNCs.

PCI 2013

THE VIETNAM PROVINCIAL COMPETITIVENESS INDEX 2013

3 PARTICIPATION IN LEGISLATIVE DRAFTING AND REGULATORY COMPLIANCE: EVIDENCE FROM ACROSS VIETNAM'S 63 PROVINCES

SUMMARY

Using data from the PCI's domestic survey, we find that a firm is more likely to comply with business regulations when it participates in the design of the regulatory framework. Importantly, we find evidence that this only holds when the firm views government as attentive to its input. There is reason to believe that participation may actually be associated with less compliance when government is seen to be disinterested.

This result provides a clear policy recommendation. According to the current *Law on Laws*, government agencies are required to put regulations out for public comment for sixty days and to collect and respond to those comments in a table. Unfortunately, there is no legal obligation to publically release the table and it is extremely rare for a Ministry or local government to do it voluntarily. Our findings suggest, however, that doing so is critically important to achieving the positive benefits of public participation. When businesses provide sincere and thoughtful comments, but do not see their suggestions used or even any hint that the government acknowledged their input, their confidence in the process declines and they are statistically less likely to abide by the strictures of the regulation. Our results indicate that the public release by Ministries of the table of responses to suggestions by businesses may provide a credible demonstration to businesses that their feedback is taken seriously.

Examining the mechanisms behind these findings, we show that a firm's knowledge about its regulatory environment increases with its level of engagement in the drafting of regulations. A firm's attitude about government, however, mirrors our findings on compliance: participation improves perceptions of government effectiveness only when government is seen to be responsive and actually decreases confidence in policy when this is not the case. When officials did not respond to their suggestions, firms that took time to comment on draft regulations actually voiced lower opinions of local agencies than firms that did not provide any comments at all.

We note that our effort to test theory in this space still faces significant issues of selection bias and endogeneity. The firms most likely to provide comments on regulations are the largest and most connected firms in Vietnam, and they are also the most likely to worry about punishment for non-compliance. In the final section, we lay out an experimental research agenda to study participation and regulatory compliance that will resolve these problems, and provide more thorough evidence about the potential benefits and limitations of expanding public participation to smaller, less visible establishments.

3.1 INTRODUCTION

Châu Linh Uyên was horsing around with friends in March 2010, when her hand rested on an ATM outside her Ho Chi Minh City primary school. The 10-year-old shook with the power of 100 volts and died in front of her classmates. This was no isolated tragedy: in the weeks that followed, police revealed that 14 percent of the city's 866 ATMs were not properly grounded and 61 machines were shut down for regulatory non-compliance.[40] Accidental electrocutions in Vietnam, numbering 400-500 per year, were usually due to regulatory lapses, such as faulty wiring or improper weather insulation.[41]

As with more recent cases of the garments factory collapse in Bangladesh that killed over a thousand workers[42] and the more than 16,000 dead pigs found in China's Huangpu River,[43] the Vietnam ATM story is symptomatic of a larger phenomenon observed across developing countries: the increasingly daunting task of minimizing the negative effects of individual businesses on the natural environment and local communities. This vital task is made difficult by the combination of, on the one hand, government's limited capacity and, on the other hand, the dynamic growth in the number of firms—especially of the small and medium sized variety—over which government is responsible. The potential consequences at stake are substantial, in terms of both tangible harm to citizens and workers and confidence in policy-makers.

The above are all poignant examples of where governments The Vietnam ATM disaster, the dead pigs floating in Hoangpu River and the collapses of Bangladesh garment factories failed to ensure compliance with existing business regulations. This illustrates that the problem is rarely a paucity

40 Magnier 2010, Thanh Nien 2010.
41 Vietnam News 2009.
42 BBC 2013.
43 The Gaurdian 2013.

of laws or regulation; rather, it is their poor enforcement and the limited capacity of regulators that endangers people. Too often businesses and individuals skirt the law, knowing the chances of being caught are minimal. The intent of these (often smaller) businesses need not be malicious; it can simply be that they feel insufficient connection to rules crafted in a far-flung capital by policymakers with little understanding of their significant day-to-day challenges.

Corruption also plays a role. As the *LA Times* hinted, businesses may bribe their way out of proper enforcement. However, a less appreciated result of bribery may be even more pernicious. Corruption undermines businesses respect for the rule of law, as businesses come to associate regulations more with bribe extraction than the public interest. This is abundantly clear in this year's PCI, wherein 41% of Vietnamese businesses agreed with the statement that local officials use the handling of administrative procedures to harass firms, implying regulations are used to solicit bribes.

The key puzzle for governments and development practitioners is how to improve compliance with the law in states characterized by weak bureaucratic capacity, thereby protecting the most vulnerable in society. A large but relatively untested theoretical literature in political science points to enhanced participation as a potential answer to this conundrum.

Conventional wisdom argues for greater spending on enforcement. It is generally understood that rules truly matter only if they are enforced.[44] Punishment for non-compliance is the form of enforcement most commonly associated with government regulation and appears to be a relatively effective form of enforcement.[45] Punishment, however, is also quite costly for the enforcer and governments in emerging economies that tend to be highly resource constrained—whether the resources are money, human capital, technical capacity, or time. As a result, solutions to the problem of regulatory non-compliance in emerging economies, predicated on more competent enforcement by government are neither very realistic in the short term, nor are they likely to serve as useful guides for constructive action.

The main academic solution for this critical social predicament is self-regulation. Self-regulation grants maximum agency to firms, the primary focus of management researchers, rather than ceding power to government. It also fits more easily with the prevailing paradigm of government regulation—especially with respect to emerging economies—as a "grabbing hand" that needs to be pushed back to facilitate business entry, growth, and innovation. Prominent forms of self-regulation include firm-specific responses through corporate social responsibility (CSR) programs and industry group responses that set up structures to police their own communities. The evidence from management literature on whether these responses serve as meaningful substitutes for a competent system of government regulation is mixed.[46] Most importantly, there is essentially no evidence of successful self-regulation in the particularly challenging setting of emerging economies.

Another increasingly popular strategy for reducing behavior by firms that is harmful to society is to empower other stakeholders as counterweights (i.e. strengthening labor unions, consumer groups, or social organizations). Such arguments reflect a perspective of the nature of all relations between firms

44 See Greif 1993; Ingram & Clay 2000; Ostrom 1990.
45 Andreoni, Harbaugh, & Vesterlund 2003.
46 See King & Lenox 2000; Margolis & Walsh 2003.

and government, and between firm interests and those of society that dominates academic research.. For example, work on firm agency vis-à-vis government has tended to focus on large firms and the self-interested lobbying strategies by which they bend institutions to gain competitive advantage over competitors.[47] In developing economies, political connections and relations with top decision-makers are the most likely form of such pernicious participation by businesses in design of the regulatory framework.[48]

Distinct from all of the above-described perspectives, this chapter proposes and tests the hypothesis that more institutionalized and broad-based dialogue between businesses and government is more socially beneficial than the status quo, because it may increase regulatory compliance. Importantly, we propose a set of possible mechanisms to govern this relationship, each of which has distinct implications for researchers, managers, and policy makers. Our findings lend support for an agenda of deepening the rather substantial steps Vietnam has already taken towards more institutionalized engagement with firms about design of the regulatory framework for business. These steps have included:1) business-government forums; 2) "public comment periods" for draft regulations and laws; 3) drafting committees that include member of the business community and associations; 4) provincial delegation offices for specially designated Vietnamese National Assembly (VNA) delegates to interact with their provincial constituencies; 5) and direct contact with local officials through hotlines, meetings, and phone calls.

This chapter and our broader research agenda are especially concerned with Vietnam's embrace of online public comment on regulations. International evidence has shown that public comment periods have had significant impact on the evolution of new regulations.[49] The adoption of such open and participatory processes in states like Vietnam and China is clearly driven by both the urgency of the need for stronger institutions and government belief that these policies may actually work. They are joined in this belief by a growing movement across international development organizations to promote public input, including by companies.

We find tentative empirical support for our theory in PCI survey data on participation in the drafting of regulations in Vietnam. While participation in legislative drafting leads to higher regulatory compliance by firms, this relationship can be reversed if the government ignores the input. Our data allows us to dig deeper and explore the mechanisms behind these findings. Consistent with research in political science about the benefits of participation at the individual level, we find evidence that participation in the drafting of regulations increases both knowledge about the regulatory framework and confidence in the government seeking to implement it. Specifically, we find that firms' knowledge increases with deeper government engagement, while improvements in attitudes

> " *...firms' knowledge increases with deeper government engagement, while improvements in attitudes about policy-makers come about only when government is an active partner.* "

[47] See Hillman & Hitt 1999; Pearce, De Castro, & Guillén 2008.
[48] See Fisman 2001; Khwaja & Mian 2005.
[49] See Cuéllar 2004; McKay & Yackee 2007; Naughton, Schmid, Yackee, & Zhan 2009; Shapiro 2008; Yackee & Yackee 2006; Yackee 2006.

about policy-makers come about only when government is an active partner. When officials are not responsive, participating firms actually hold lower opinions of authorities than firms that do not participate at all.

3.2 THE THEORY OF PARTICIPATION AND REGULATORY COMPLIANCE

The theoretical intuition that underlies the motivation for public participation in legislative drafting has a long history in philosophy and political science, involving some of the greatest minds in the disciplines. The basic premise is that active participation in decision-making produces more sympathy with opposing views, respect for evidence based reasoning, and, critically for us, ***a greater commitment and a higher probability of compliance with government's rules.***[50] This philosophical work has received support from two completely unrelated disciplines. Social psychology experiments have shown individuals are more likely to follow rules they have had the opportunity to influence.[51] In the management literature, human resource research has found that active participation of employees in decision making leads to their greater commitment to firm objectives.[52] Applying this logic to the participation of businesses in regulatory drafting, we hypothesize that:

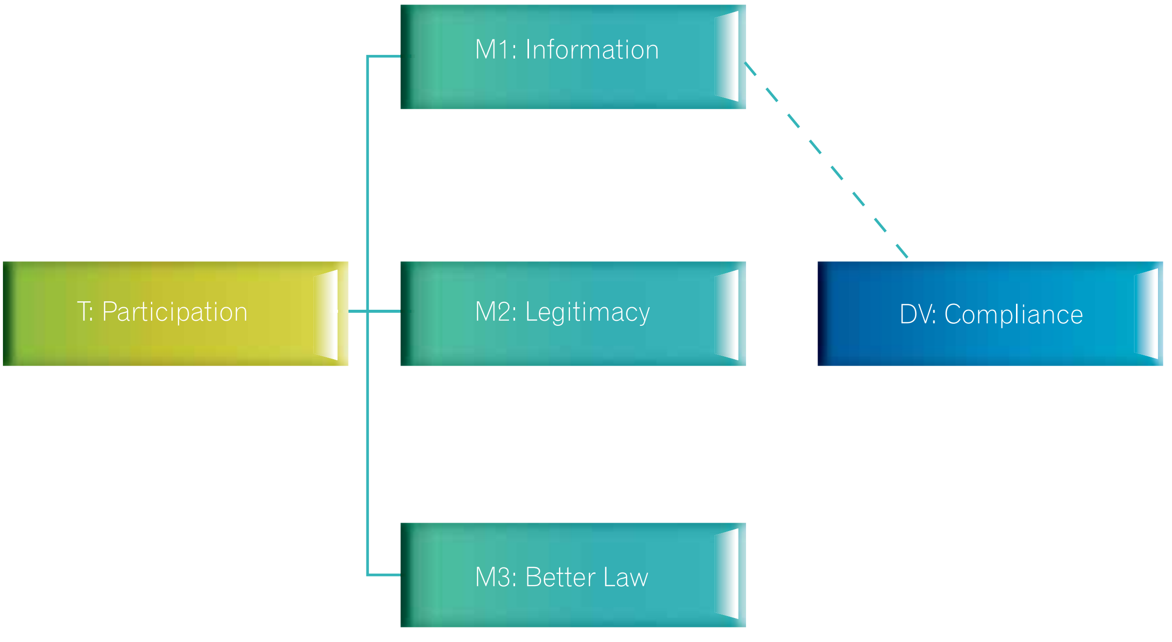
Hypothesis 1: A firm that participates in the drafting of new business regulations is more likely to comply with business regulations.

How does Participation Affect Compliance? Three Potential Mechanisms

At least three potential mechanisms lay behind the larger theoretical relationship. Figure 1 details our key research hypotheses.

50 Verba, S., Nie, N. H., & Kim, J. O., 1978, Fishkin, J. S., 1991, Fung, Archon. 2004.
51 Korsgaard, et al. 1995; Tyler, 2006.
52 Chan, and Renee A. Mauborgne 1993, Korsgard et al. 1995, Naumann and Bennet 2000

FIGURE 3.1 Theoretical Mechanisms Linking Participation and Compliance.



First, some scholars argue that the process of participation teaches citizens and firms about the law. These more informed stakeholders are less likely to make mistakes which lead to accidental violations.[53]

Mechanism 1: A firm that participates in the drafting of new business regulations will be more informed about its own regulatory environment.

Second, after participating, citizens and businesses come to see the legislative process and governing institutions as more credible and demonstrate more confidence in the regulations.[54] This is perhaps the most developed theoretical relationship. In the environmental policy literature, for instance, scholars have found that self-reported feelings of trust and confidence are associated with greater willingness by citizens and business to comply with the boundaries of protected areas and marine reserves.[55]

Mechanism 2a: A firm that participates in the drafting of new business regulations will have a more positive attitude about government.

53 See Fearon 1998, Goren 2004, Mackie 2006, Keefer and Khemani 2011.
54 See Cohen 1997, Salisbury 1975, Weatheford 1992, Fishkin et al 2010
55 See Green 1997, Viteri and Chavez 2007, Stern 2008.

Mechanism 2b: A firm that participates in the drafting of new business regulations will be less likely to view regulations as excuses for rent-seeking by bureaucrats.

There is an important corollary to the above confidence mechanism. Psychological studies have shown that consistently unmet expectations can generate a permanent sense of disappointment and anger, as well decreased public confidence and trust.[56] If actors participate, but their concerns remain unaddressed, these negative experiences may lead them to interpret actions in a more negative manner, regardless of the objective evidence. When it comes to legislative participation, it is reasonable to expect that disappointment might aggregate to the level of businesses. If managers spend a great deal of time and energy analyzing policy and commenting on it, but their comments are not acknowledged or used in the eventual outcome, participation might actually have a backlash effect – damaging perceptions of confidence and ultimately compliance rather than helping it.

Corollary to M2: Participation without a government response will damage willingness to comply with new regulations.

Third, participation is thought to improve legislative quality by identifying problems and better tailoring policy to local preference and needs.[57]

Mechanism 3: Regulations, which are subject to public participation in draft stages, will be of higher quality, more suitable to the needs of businesses, and easier to implement.

Although compelling, it is extremely difficult to test this third mechanism empirically. The problem is that, unless firm-level preferences are highly variegated, it is unlikely that participants and non-participants will differ dramatically in their preferences over the regulation. Consequently, if the participants' ideas significantly improve the quality and acceptability of the laws, non-participants are as likely to change their behavior as treatment firms. We would observe no difference between the compliance of the different groups statistically. In short, a highly successful case of participation would appear as a non-result. In the final section, we reflect on further research that could help ascertain whether the third mechanism is working. For now, however, we bracket analysis of that pathway.

3.3 PUBLIC COMMENT PERIODS IN VIETNAM

Vietnam offers a particularly attractive location to test the above theories. It is an emerging market that has been growing rapidly (averaging over 7% the past two decades), recently crossing the threshold into classification as a middle-income economy. Since 2000, over 250,000 private enterprises have registered and begun operations. According to the General Statistical Office Enterprise Census, 66% of these businesses have ten employees or less, 82% have less than twenty. Small businesses are spread throughout the country, hard to reach, and have limited technological

56 Rousseau 1989, Robinson and Rousseau 1994, Morrison and Robinson 1997, Dirks and Ferrin 2002.
57 See Coglianese 1997, Coenen et al. 1998, Stern 2008, Horsely 2010.

capacity. In short, they constitute exactly the type of population for which regulatory compliance is hardest to achieve.

Institutionally, Vietnam is also a good fit. In 1996, the Vietnamese National Assembly adopted "The Law on the Promulgation of Legal Normative Documents," popularly known as the Law on Laws (LoL). It was later revised in 2002 and 2008. Critically, the 2008 version of the LoL contains a provision (Article 61) requiring that a lead agency (e.g. a line Ministry)[58] charged with drafting a regulation must post the draft for a minimum of 60 days for public comment, study the comments, and file an internal report on why the comments were accepted or not accepted. Article 62 specifically lays out the format for facilitating participation including digital submission of comments:

> *"Collection of comments and ideas as inputs for the development of the draft decree can be undertaken in the form of direct comments and suggestions, circulation of the draft decree for comments and suggestions, organizing consultation workshops, making use of websites of the Government and the lead drafting agency or mass media."*

The LoL formally requires that the lead agency produce a table of public comments. The table is essentially a spreadsheet that itemizes each of the comments received during the public comment period through different media (including internet, telephone, and during conferences). Agencies are obligated to answer whether the comment was included in the final draft and provide a written explanation for why the comment was not considered. According to current Vietnamese law, however, this table does not need to be made publically available, but is intended solely for internal use. As we will highlight below, altering this policy to allow for a public release would be highly beneficial, as it would allow for formal documentation of government acknowledgement and whether a firm's comments found their way into the legislation, which would go a long way to generating greater confidence in the system in the eyes of participants.

Although it is slightly beyond the scope of this chapter, there is an important question of why Vietnam has adopted these participatory mechanisms. Many observers tend to cite the fact that these provisions were required under the transparency provisions of Vietnam's WTO accession.[59] In fact, Vietnam has a long history of public participation in legal drafting. The process has been used to generate legitimacy and information about key changes being considered.[60] Every constitutional revision since 1991 included a process of soliciting opinions from intellectuals, experts, and heads of mass organizations. Strong debates exist, however, about how seriously public comments have been taken and whether or not the exercises have been pro forma. [61]

China provides an interesting comparator, as it has taken great lengths to extend public participation in drafting through online portals. Chinese scholars have argued that these mechanisms serve the valuable role to regime leaders of increasing legitimacy and regime resilience.[62] Truex (2013) found in an online survey experiment in China that the legitimacy effects of participation were strongest for

58 Also see Articles 35, 62, 67, 68, 69, 70, 71, 72, 74
59 Weeke et al. 2008.
60 Sidel 2002.
61 Thayer 1992.
62 Sidel 2002.
63 Horsely 2009, Truex 2013, Georguiev 2013.

the least educated and empowered. A critical finding from the research on China is that laws and regulations that have provisions for public comment are significantly less likely to be amended, even when controlling for importance and issue area of the document.[63] This lends support to the idea that participation creates better and more stable laws.

In sum, Vietnam provides a setting that reflects a general problem experienced by developing economies, possesses an ideal institutional setting for the experiment, and the PCI data provides a unique opportunity to see if the proposed relationships exist.

3.4 OUR DATA

We use the PCI domestic survey to test our theory that a firm's participation in the drafting of new regulations is positively related to its regulatory compliance. The domestic survey provides significant variation on both the level of participation engaged by respondents and their ultimate compliance with several critical regulatory measures. We divide our data discussion into three parts. First, we introduce the outcome variables we would like to explain, which are known in empirical research as dependent variables. Second, we explain our key causal measure of participation. Third, we discuss variables that are included in the analysis as control variables to address potential confounding effects due to third factors (sometimes called omitted variable bias).

Outcomes Variables:
Our analyses involve separate dependent variables (outcomes we would like to explain) for compliance with regulations, knowledge about regulations, and confidence in policy-makers.

Our main analyses rest on the first of these variables, Compliance, for which we use a measure of the percentage of long-term employees that have been issued a formal contract. This measure is particularly appropriate, because it captures compliance with the new Labor Code (10/2012/QH13), which was passed June 18, 2012, and went into effect on May 1, 2013, just two months before the 2013 PCI survey started. The Labor Code was subject to extensive participation by domestic firms and debate in the VNA. It is no exaggeration to say that the Labor Code was the regulation most likely to be on the minds of firms when they sat down to participate in the survey. Beyond the ideal timing and extensive participation, the Labor Code is especially useful for us, because it affects every firm in Vietnam and therefore offers a general measure of compliance. Other fine-grained regulations are more precise, but often only apply to specific industries or types of firms. Labor contracts apply to all firms and therefore are more amenable to statistical analysis with large samples.

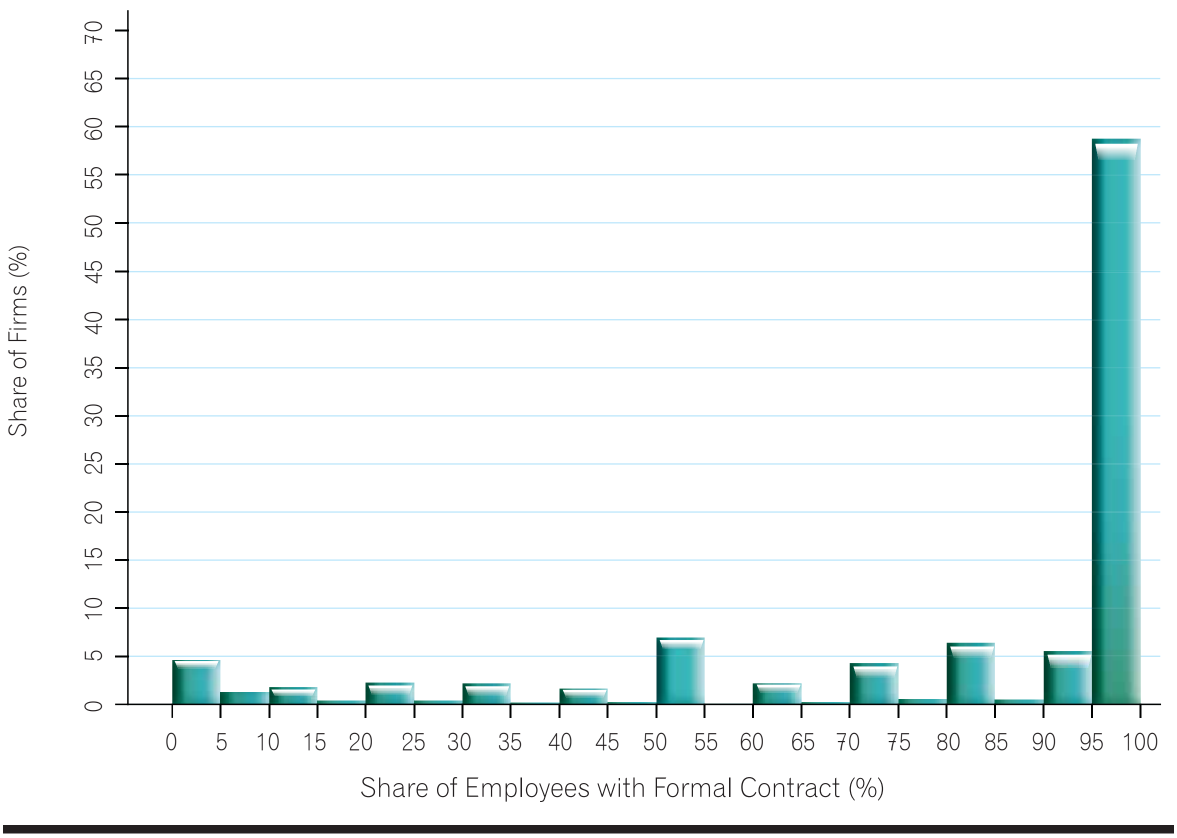
Within the Labor Code, we focus on labor contracts, because this portion of the code received the greatest change, and was subject to the greatest amount of public debate. In particular, the new code makes extremely clear in Article 18 that labor contracts are required and must be signed

[64] Geoguiev 2013.

between the employer and the employee before the beginning of long-term, full-time work. This includes seasonal labor, which did not require contracts under the 1994 and 2000 version of the code. Article 19 further adds that workers must be informed of working conditions, their duties, and rights, before the signing of the contract. This is to avoid a situation where employers try to escape their obligations to pay insurance, etc., and deprive workers of their statutory rights and benefits. Importantly, contracts are still mandated for short-term work (under 3 months), but these maybe concluded verbally (Article 16). Although there are some exceptions to Article 18 for part-time work, it is quite clear that all long-term workers are meant to have a contract, and the share of employees with contracts provides an extremely useful, continuous measure of compliance that varies heavily across firm type.

Figure 3.2 demonstrates the distribution of our first outcome variable. About 56% of firms are fully compliant with 100% of their workers under contract. Thus, mean compliance is quite high: around 72%. Nevertheless, there are a significant number of operations that fall demonstrably short. Four percent of firms (240 operations), do not have a single one of their roughly 2,830 employees under formal contract. About 15% of operations have less than half their employees under formal contract. Most strikingly, 21% of businesses did not answer the question at all, indicating sincere concern about revealing lack of compliance.[65]

FIGURE 3.2 **Compliance 1 - Share of Employees with Formal Contract**



[65] In this report, we do not present results correcting for missing data. Nevertheless, results based on imputing responses to the formal contracting question using advanced statistical procedures such as multiple imputation (MI) reveal similar answers.

FIGURE 3.3 **Compliance with Labor Code by Firm Size**

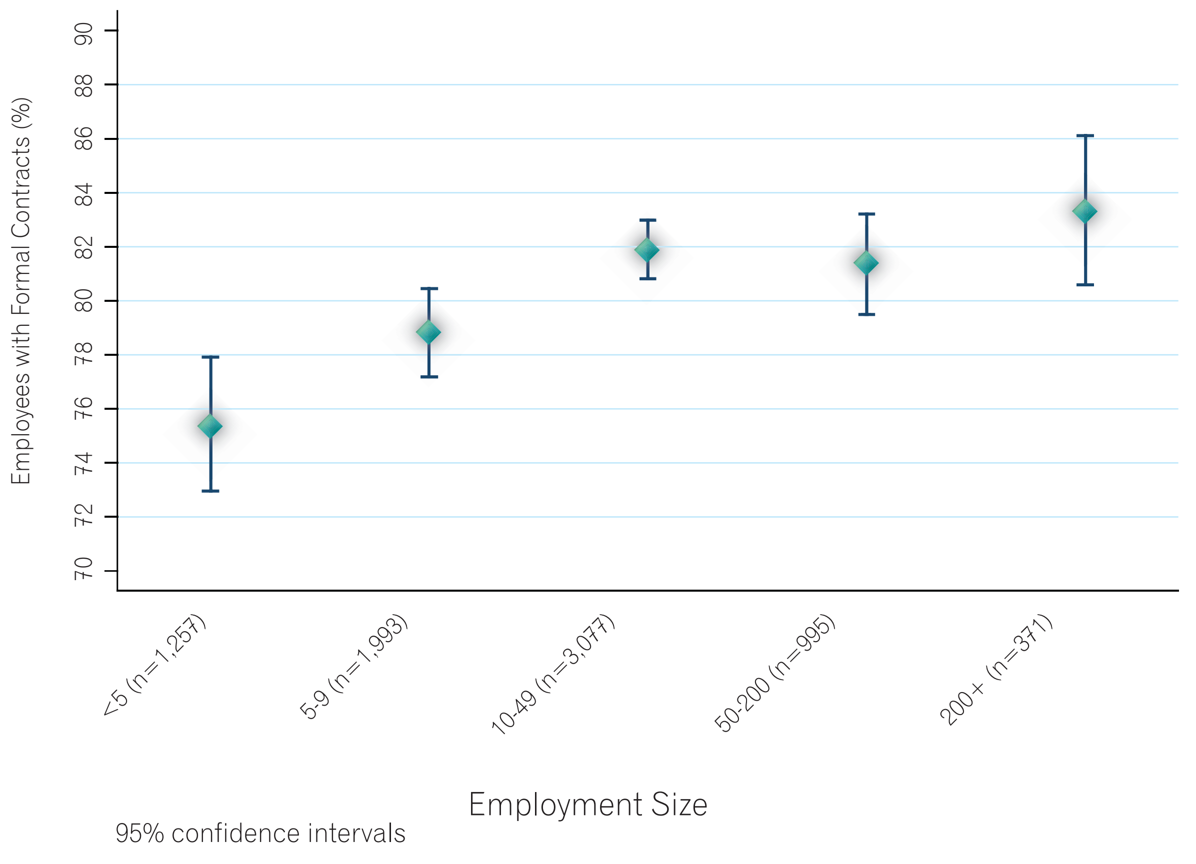


Figure 3.3 plots our measure of compliance by firm size by number of employees. In the graph, diamonds represent the average score for a size category, whereas the range bars depict 95% confidence intervals around the mean. The first thing to notice is that there is a positive relationship between compliance and employment size. The bigger a firm, the more likely we are to observe compliance with the 2013 Labor Code. There are a number of reasons why size is correlated with contracting. Larger firms may face greater scrutiny from regulatory authorities. Size may be associated with more sophisticated operations, which need to compete more vigorously for employees by offering better terms. Larger firms are more likely to operate in international markets, where their partners expect higher levels of labor treatment. Regardless of the reason, the clear implication of the graph is that the greatest non-compliers are the smallest and least visible operations.

A closer look, however, reveals that there is not a statistical difference between firms with 10 to 49 employees and the two larger categories. In other words, once a firm reaches a threshold of 10 employees, size plays little role in its decision to offer formal contracts. This is useful, because it lets us know that variation in formal contracting must result from other factors – size is an insufficient explanation.

Our supplemental analysis of the mechanisms underlying the relationship between a firm's legislative participation and its regulatory compliance are conducted using the following two dependent variables to measure a firm's knowledge about its regulatory environment for Mechanism 1:

M1.1. Predictability, which is based on a firm's own estimation of its ability to successfully predict government's regulatory behavior. It is drawn from Question F7 in the PCI survey, *"How predictable is the implementation of these rules, laws, and regulations at the provincial level?"* Firms are invited to answer on a five-point scale ranging from 1 (Never) to 5 (Always). Average predictability was 2.08 with 65% of firms answering that implementation of regulations was never or rarely predictable.

M1.2. Time Understanding, which is based on a firm's reporting of the amount of the time it spent doing research to understand government regulations and how to comply with them, which is drawn from Question D6 in the PCI survey. Firms answered on a six-point scale ranging from 1 (Less than 1%) to 6 (Over 50%). Average time spent was about 2.45 with 64% of firms answering that they spend less than 5% of their time on such activities.

We also measure a firm's perceptions of officials (Mechanism 2) using the additional following two dependent variables:

M2.1. Attitude, which is based on a firm's perception of the friendliness of provincial government policy towards the private sector on a five-point scale ranging from 1 (Negative) to 5 (Positive). The exact wording of the Question H1 is, *"What do you perceive as the attitude of provincial government officials towards private business?"* About 56% of firms chose the neutral category (3), leading to an average score of 3.46. On the optimistic side, 43% of firms did choose the somewhat positive (4) or positive (5) options.

M2.2. Extract Rents, which is used to measure whether firms believe that regulations are abused for the purpose of benefitting local bureaucrats. If this is the case, firms are unlikely to trust the public interest purpose behind regulation. To measure this, we use Question D14.2, which asked firms whether they agreed with this statement *"Rent-seeking phenomenon is popular in handling administrative procedures for businesses."* About 41% of firms in Vietnam agreed or strongly disagreed with the statement, which was carefully worded to imply the abuse of red tape for personal advantage. We reversed the coding of this variable, so that higher scores imply agreement with the statement.

Independent Variables:

We use three different variables to represent increasingly significant forms of political participation by firms in the drafting of new business regulations. These variables all are derived from a battery of question in Section F.3 of the PCI survey. The actual wording of each question is presented below.

3. Have you ever provided comments on the Government's regulations and policies?

- ❑ Yes (Please answer question 3.1 and 3.2)
- ❑ Never (Please skip to question 4)

3.1. If yes, which channel in your opinion is the **most effective**? (Check ✓ only one option)

- ❑ Public – private dialogues
- ❑ Provincial delegations of the National Assembly
- ❑ Provincial website, online dialogue forums
- ❑ Business and professional associations
- ❑ Direct comments to relevant state agencies
- ❑ Others (please specify)..

3.2. Did your comments receive responses from authorized agencies?

- ☐ Yes
- ☐ No

3.3. Didid the authorized agencies use your comments?

- ☐ Yes
- ☐ No

The first and broadest measure (F3), *Provided Comment on Draft Regulation*, equals one if a firm contributed any comment on a draft piece of regulation to the government within the past year and equals zero if it did not. Our second measure of participation (F3.2) narrows down to just those commenting firms whose comment received a formal government acknowledgement *(Received Response from Government to Comment)*. This is considered to be a higher form of participation, in that the firm received some evidence that government is aware of its perspective. Our third and final measure, *Comments Used in Final Regulation* (F3.3), is then the highest form of participation, in that the firm understands its comment to have actually contributed to affecting the desired change.

How were these comments made? Table 3.1 shows that nearly two thirds of firms (60%) communicated their comments on draft regulations to government through attendance at business-government dialogue workshops. The second and third most common avenues for comments were through business associations like VCCI and Young Entrepreneurs Association (14%) and direct communications with relevant state officials (11%). It is remarkable, given the attention it has received, and the importance of the process in WTO negotiations and Vietnamese policy-making, that online forums accounted for less than 8% of comments.

TABLE 3.1 Channels for Commenting on Draft Regulations

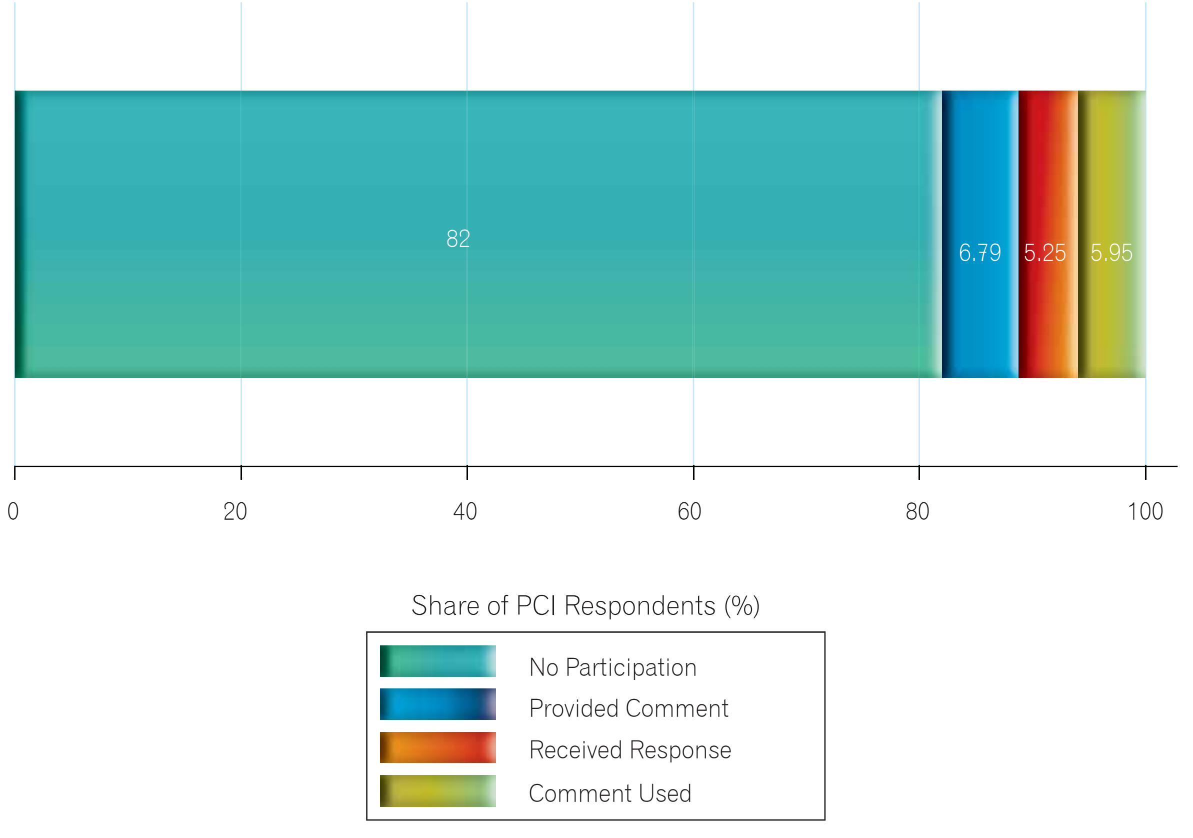
Type of Participation in Decision Making Participation in Decision Making	Total		Received Response		Comment Used	
	n	%	Mean	SE	Mean	SE
Business-government dialogue	802	59.76	67.4%	1.6%	36.0%	1.6%
Local deputies to the National Assembly	58	4.32	54.5%	6.2%	34.8%	5.9%
"Dialogue forums on the internet, provincial website"	100	7.45	42.6%	4.4%	20.2%	3.5%
Business associations and trade associations	193	14.38	48.2%	3.3%	29.4%	3.0%
Direct comments to relevant state agencies	153	11.4	56.1%	3.7%	36.7%	3.6%
Others	36	2.68	15.4%	5.1%	7.7%	3.7%

There appears to be some relationship between the frequency with which firms used particular avenues for communicating their comments on draft regulations and the effectiveness of those comments. Table 3.1, for example, further shows that comments delivered through the popular avenue of business-government dialogues were most likely to have received feedback from government (67%) and placed a close second to direct communications with relevant government agencies, in terms of whether they were seen to have had an effect on the final regulation (36%). In marked contrast, communications through online forums were, by far, the least likely of the main avenues to have received a response from government (43%) or been seen to have had a real impact (20%).

Figure 3.4 below depicts the distribution of offering comments on new regulations. As we have noted above, given the timing of the Labor Code and the intensity of response, relative to other legal documents, it is extremely likely firms were thinking of the Labor Code when considering their participation.

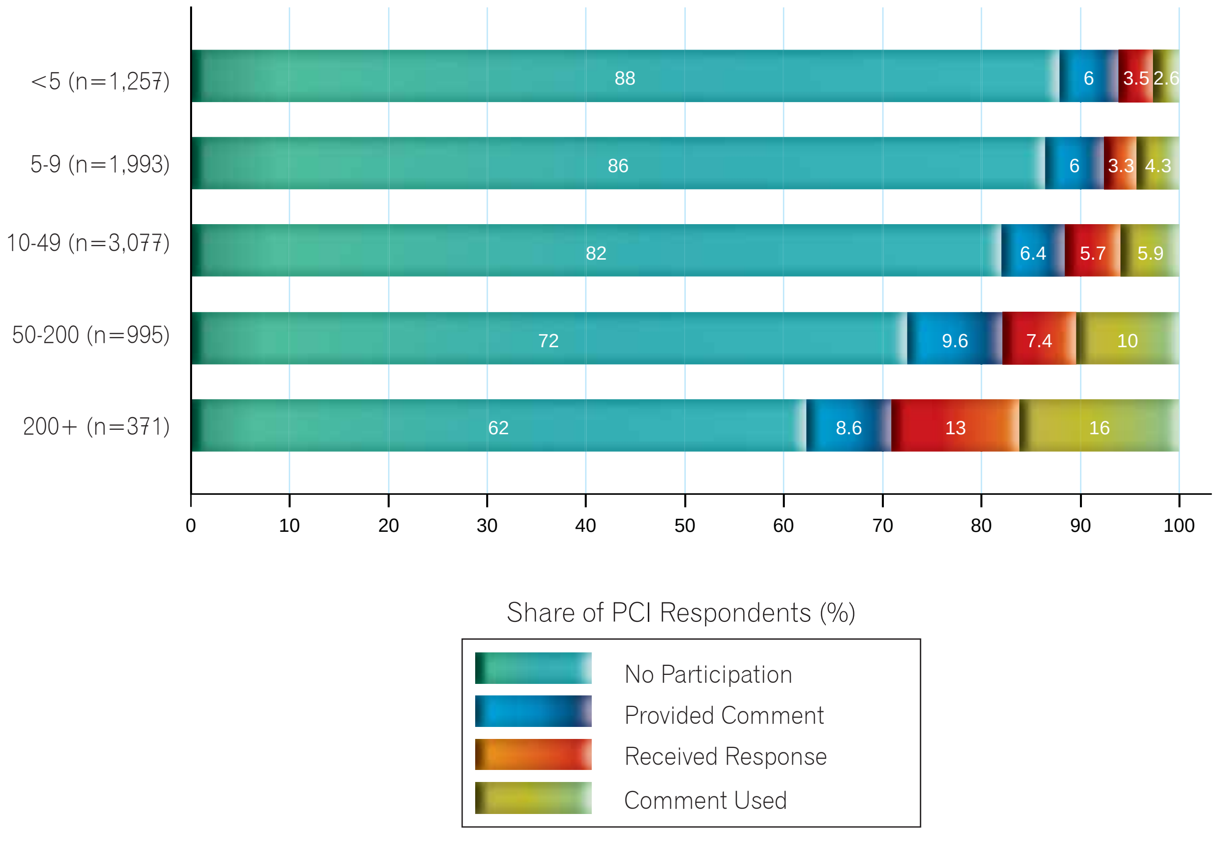
Most Vietnamese companies (82%) do not provide comments on draft regulations. Of the 18% that do provide such comments, less than two thirds either say they received a response from government or believe their comments to have led to substantive changes to the regulatory environment.

FIGURE 3.4 Comments by Vietnamese Firms on Draft Regulations



Of course, it is naive to treat all firms as the same. Larger firms have greater resources at their disposal, and therefore are more likely to get involved in drafting. Figure 3.5 probes this, showing that, not surprisingly, larger firms are more likely to participate than are smaller firms. Thirty-eight percent of firms in the large category provided comments versus 18% in the category of 10 to 49 employees. The greater likelihood that larger firms say their comments were acknowledged or believe their comments had a real effect on final regulations is even more pronounced. Thirteen percent of large firms say their comments were acknowledged, compared to 6% of medium-size firms. Sixteen percent of large firms had their comments used in the eventual regulation, over twice the amount of medium-size firms.

FIGURE 3.5 Comments on Draft Regulations and Firm Size



Another confounding factor is connection to government officials. Firm managers who are former government officials, army officers, or SOE managers have far easier channels to regulatory drafters and more influence over the process. Figure 3.6 indicates that firms with such connections proved nearly twice as likely to comment on draft regulations, to say their comments were responded to, and to feel their comments had an impact on the outcome.

FIGURE 3.6 Comments on Draft Regulations and Government Connections

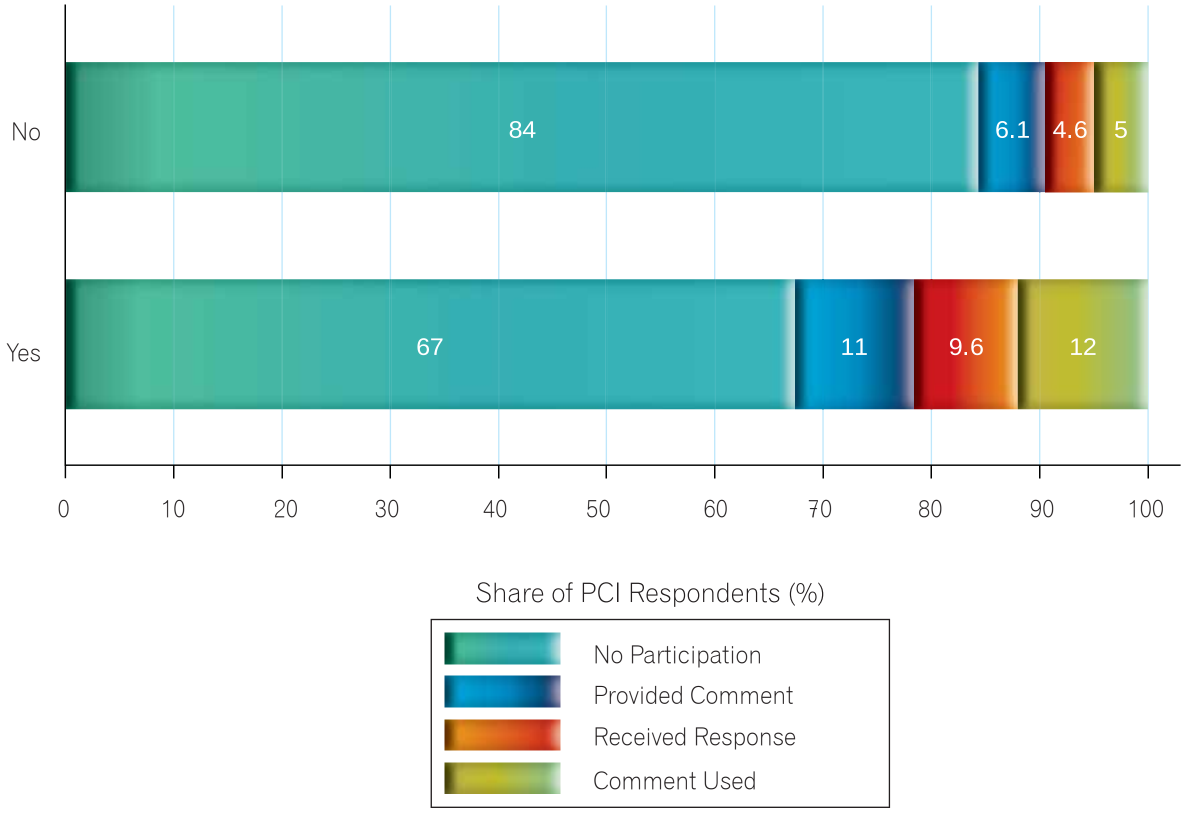


TABLE 3.2 Type of Participation in Decision Making (by Size)

Type of Participation in Decision Making	No Connections					Connections to Officials				
	<5	5 to 9	10 to 49	50-199	200+	<5	5 to 9	10 to 49	50-199	200+
Business-government dialogue	59.65	62.56	59.49	57.41	63.22	60.87	55.81	63.03	66.67	52.08
Local deputies to the National Assembly	3.51	3.45	4.56	0.62	5.75	8.7	11.63	5.04	3.13	4.17
"Dialogue forums on the internet, provincial website"	13.16	9.85	8.86	5.56	3.45	0	4.65	5.88	4.17	2.08
Business associations and trade associations	7.89	9.36	14.68	21.6	17.24	8.7	18.6	15.13	18.75	12.5
Direct comments to relevant state agencies	8.77	10.84	11.39	10.49	9.2	17.39	6.98	9.24	6.25	25
Others	7.02	3.94	1.01	4.32	1.15	4.35	2.33	1.68	1.04	4.17

In addition to the observable differences in the scale of participation by size and connections, type of participation also varies considerably across these groups. Business-to-government dialogues were the preferred method for everyone. Beyond that, however, online forums were primarily popular among smaller firms without government connections. Business associations were the second preferred choice of medium and large firms without connections. For large firms with connections, a clear mode stands out. Twenty-five percent of firms in this special category prefer taking their concerns directly to state agencies.

Control Variables.

The fact that size and government connections are associated with both more participation and somewhat greater compliance poses a problem for our analysis: omitted variable bias. For instance, it is possible that large firms are more scrutinized than smaller firms and are therefore more likely to comply. At the same time, large firms have greater influence and therefore are more likely to participate, and to have their voice heard. Thus, large firms are both more likely to participate and comply, but there is no clear causal relationship – we are simply observing a correlation caused by confounding factors (e.g. large firms just do more of both). If we did not address this empirically, this would lead us to over-estimate the effect of participation, by attributing theoretical importance to the activity, when mere size is really the driving force. By including size in our regression analysis, we "control" for size by essentially comparing only firms of similar sizes to each other. Essentially, we measure participation within comparable sizes rather than across them. The result of the regression provides the average effect of participation across the different size categories.

Size is not the only source of potential omitted variable bias. There are a large amount of factors that can influence both participation and compliance. We address this threat to inference with several other control variables of firm-level characteristics in our full models.

All models in this study include fixed effects (i.e. dummy variables) for province and for broad industrial sector in order to hold constant the direct impact that these characteristics may have on regulatory compliance, by comparing firms only to other businesses within their provinces and sectors. We also control for the number of employees for each company (measured on an eight-point scale in Question A8.3), the company's equity (measured on eight-point scale in Question 7.3), and a series of dichotomous (dummy) variables that equal one if any of the following are true (and zero otherwise):

- The Vietnamese Government is a full or partial equity owner;
- The Vietnamese Government was in the past a full or partial equity owner;
- The main owner/manager of the company was ever a government official, military official, or state-owned enterprise manager;
- The company was previously registered as a household enterprise (*ho gia dinh*) or other less formal enterprise form;
- The company is registered as a sole proprietorship; and
- The company is registered as a joint stock company.

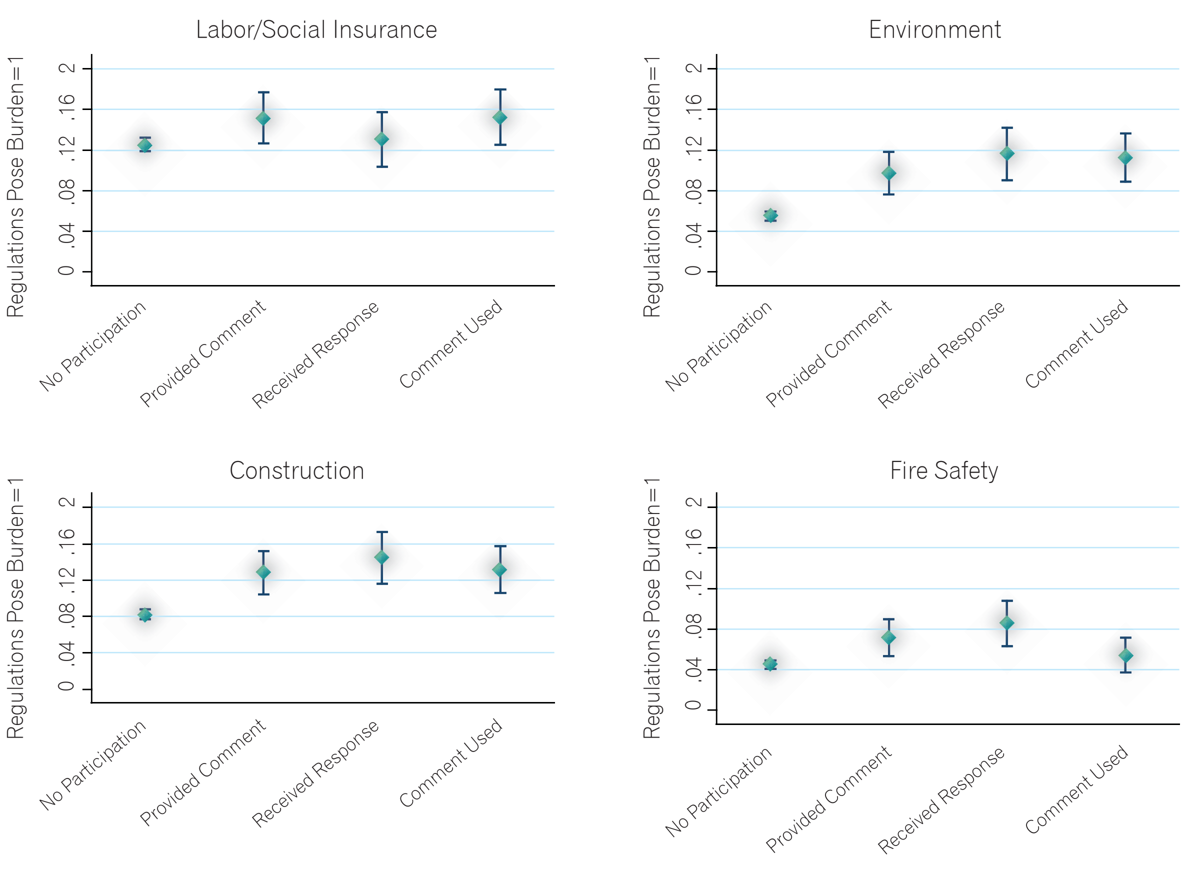
3.5 TESTING OUR THEORY

Overall, we find only relatively weak evidence in favor of a straightforward direct effect of political participation by firms on their regulatory compliance. More interestingly, however, we find quite strong support for the idea that the effect of political participation on compliance is heavily moderated by the manner in which government responds to political participation.

Regulatory Burden

Before jumping into the regression analysis, let's begin by looking at how firms across the different levels of participation perceive their regulatory burden. In Figure 3.7 below, we present the share of firms that answered that each of four common regulations was a burden to their operations (labor, environment, construction, and fire safety). Diamonds represent the mean share and blue range bars represent the 95% confidence intervals around those means.

FIGURE 3.7 **Regulatory Burden by Political Participation Level**



90% confidence intervals

The first thing to notice about the graph is that as we discussed above, labor was foremost on the minds of firms at the time they took the survey. Overall, 13% of firms selected labor and social insurance regulations, compared to 6% for environment, and less than 5% construction and fire safety.

The second thing to see is that firms that commented on draft regulations tended to be firms that perceived regulations to be a greater burden. This was the case across a number of areas of regulatory activity. This means, critically, that firms who were troubled by the regulations felt more incentive to comment – a possible source of selection bias, whereby participation is driven by fear of regulation.

The third point to note, however, is that there is no significant difference across the participation scale, once a firm provided a comment. Critically for us, firms that commented but did not receive a response judge the regulatory burden across all four regulations to be about the same. Thus, if we find any differences between levels of participation, we know that those differences were not caused by the prior beliefs about the degree of regulatory burden.

Main Empirical Results: Regression Analysis

To assess the relationship between participation and our measures of compliance, we now move to multiple regression analysis, where we regress the share of workers with labor contracts on our measures of participation, controlling for the potential confounders described above.[66] The results of our regression models are presented in Table 3.3 below.

66 We use a simple Ordinary Least Squares (OLS) model with fixed effects. Standard errors are clustered at the province level, as it was the primary sampling unit for the PCI.

TABLE 3.3 **The Relationship Political Participation on Regulatory Compliance**

Dependent Variable: Share of Full-Time Workers with Contracts	**Full Sample**						**Commenters w/Response**	**Commenters w/o Response**	**Full Sample**		**DV = Share of Firms with Trade Union**	
Key Independent Variables	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)
Provided Comment=1	1.891**	0.043						-2.808*	-2.968**	-3.019**	0.046***	0.046***
	(0.963)	(1.008)						(1.534)	(1.504)	(1.505)	(0.014)	(0.015)
Received Response=1			3.335***	2.217*			4.910***		4.851***	3.959*	0.057***	0.054***
			(1.154)	(1.205)			(1.702)		(1.798)	(2.081)	(0.017)	(0.020)
Comment Used=1					4.162***	2.794*				1.779		0.006
					(1.490)	(1.543)				(2.091)		(0.021)
Characteristics of Firm												
Employment Size (1 to 8)		0.310		0.237		0.255	-0.568	0.385	0.262	0.258	0.095***	0.095***
		(0.436)		(0.436)		(0.435)	(0.816)	(0.484)	(0.436)	(0.436)	(0.004)	(0.004)
Capital Size (1 to 8)		1.728***		1.691***		1.699***	1.039	1.936***	1.700***	1.697***	0.041***	0.041***
		(0.398)		(0.398)		(0.398)	(0.768)	(0.442)	(0.398)	(0.398)	(0.004)	(0.004)
State Owns Shares =1		1.327		1.018		0.971	4.433	-1.107	1.164	1.068	0.250***	0.250***
		(2.582)		(2.581)		(2.583)	(3.530)	(3.249)	(2.582)	(2.584)	(0.025)	(0.025)
Former SOE =1		3.461*		3.196*		3.238*	1.128	2.991	3.252*	3.221*	0.219***	0.219***
		(1.891)		(1.892)		(1.891)	(2.910)	(2.277)	(1.892)	(1.892)	(0.018)	(0.018)
Owner is Former Official/SOE Manager=1		-2.035*		-2.247*		-2.188*	1.119	-2.829**	-2.090*	-2.096*	0.020*	0.020*

Dependent Variable: Share of Full-Time Workers with Contracts	Full Sample						Commenters w/Response	Commenters w/o Response	Full Sample		DV = Share of Firms with Trade Union	
Key Independent Variables	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)
		(1.164)		(1.161)		(1.158)	(1.897)	(1.342)	(1.163)	(1.163)	(0.011)	(0.011)
Company is Former Household Enterprise =1		-7.228***		-7.247***		-7.263***	-9.087***	-7.198***	-7.337***	-7.352***	-0.008	-0.008
		(0.878)		(0.878)		(0.878)	(1.848)	(0.953)	(0.879)	(0.879)	(0.008)	(0.008)
Legal Form (Excluded=LLC)												
Sole Propietorship =1		-2.302**		-2.348**		-2.339**	-6.727***	-1.710	-2.333**	-2.337**	-0.017*	-0.017*
		(1.050)		(1.050)		(1.050)	(2.224)	(1.137)	(1.049)	(1.049)	(0.010)	(0.010)
Joint Stock Company=1		1.298		1.259		1.273	0.315	1.355	1.239	1.238	0.089***	0.089***
		(1.147)		(1.147)		(1.147)	(2.204)	(1.267)	(1.146)	(1.146)	(0.011)	(0.011)
Sector FE	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES
Province FE	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES
Constant	80.200***	77.663***	80.117***	77.755***	80.262***	77.766***	81.157***	76.608***	77.929***	77.958***	-0.262***	-0.262***
	(1.011)	(1.694)	(1.002)	(1.694)	(0.995)	(1.694)	(3.287)	(1.886)	(1.695)	(1.696)	(0.016)	(0.016)
Observations	6,012	5,585	6,012	5,585	6,012	5,585	1,192	4,824	5,585	5,585	6,755	6,755
R-squared	0.049	0.080	0.050	0.080	0.050	0.080	0.176	0.081	0.081	0.081	0.339	0.339
RMSE	30.17	29.42	30.15	29.42	30.16	29.42	26.59	29.88	29.41	29.41	0.303	0.303

Standard errors, clustered at province level, in parentheses (*** p<0.01, ** p<0.05, * p<0.1)

We investigate the straightforward effect of political participation on compliance in Models 1 through 6. Model 1 begins with the most streamlined specification, regressing the share of firms with contracts on the variable *Comment Made on Draft Regulation*. The specification includes provincial and industry fixed effects, thereby removing any of the variance in the outcome that results from differences in provincial business environments, local cultures, or issues specific to particular industries. At first brush, the results appear compelling. The correlation with compliance is positive and significant.

But Model 1 is naive, as it does not include the confounders that we have already shown to be a threat (size and connections) or other factors like whether or not a firm has state ownership. Once we control for these factors, the coefficient reduces dramatically in size and significance. *Thus, controlling for firm characteristics, the relationship between simply providing a comment and compliance with the Labor Code is effectively zero.*

How can government acknowledgement of the comment alter this non-effect? Model 3 investigates this question by replacing the simple *Provided Comment* with *Received Response*, our stricter definition of political participation. Consistent with our expectations, this model produces a coefficient that is of substantially greater statistical significance and economic size. Furthermore, the coefficient retains a weak level of significance of $p<0.07$ when we add in controls in Model 4. All else equal, firms that received acknowledgement from government about their comment have a 2.3 percentage point higher share of workers with formal contracts than those that either did not comment at all or commented but did not receive a response.

We get a similar set of results when we replace *Received Response* with our strictest definition of political participation, *Comment Used*, in Models 5 and 6. The coefficient survives the addition of confounders and is substantively large – the use of a comment in the final regulation increases compliance with Labor Code by 2.8 percentage points.

In Model 7, we adapt our analysis by focusing in on only those firms that submitted a public comment. We examine whether having received feedback from the government had an effect on the compliance of this subsample. Consistent with expectations and with our earlier results that a comment by itself had no effect but a comment with a response did, the resulting coefficient on *Received Response* is highly significant and substantively important. *Ceteris Paribus*, firms that received acknowledgement from government about their comment have a 4.9 percentage point higher share of workers with formal contracts than those who commented but did not receive a response. This represents quite strong support for the idea that the constructive effect of legislative participation by businesses on regulatory compliance is heavily influenced by the degree to which government takes such participation seriously.

The fact that the size of the coefficient in Model 7 is twice that of Model 4 is somewhat puzzling at first glance, as it implies that the effect of receiving a response is larger when the comparison group is those that commented than when the comparison group is those who did comment at all. This seems odd, as we would expect the act of commenting to have some positive effect on its own. Could it be that participating but not receiving acknowledgement is actually dampening compliance as we suggested in our theoretical corollary to the legitimacy mechanism?

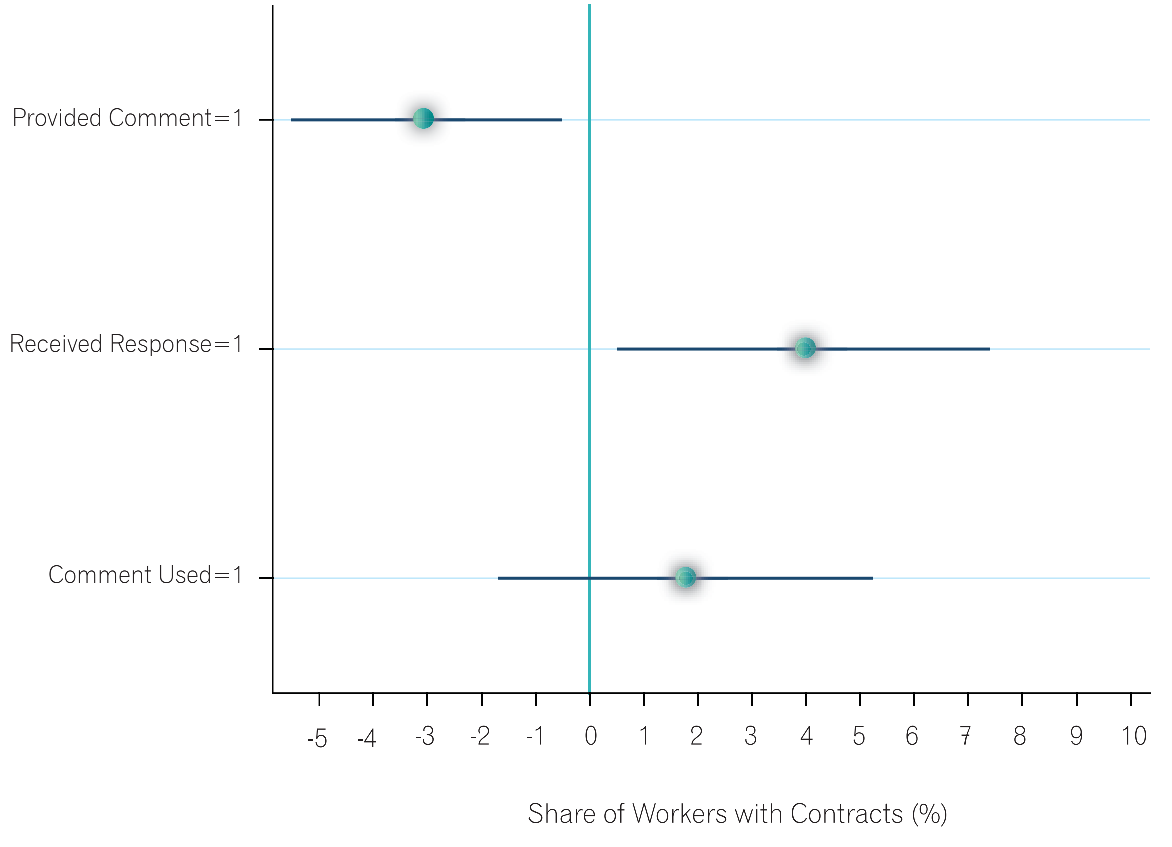
To answer this question, we shift our focus in Model 8 to just the subsample of firms that either did not comment at all or, if they did comment, did not receive any feedback on those comments from government. As we conjectured above, this shift in focus results in a flip in the sign on the coefficient for *Provided a Comment*, from positive to negative. Importantly, the negative coefficient also becomes statistically significant, albeit at the relatively weak level of $p<0.07$. Given that *Provided a Comment* within this subsample specifically excludes firms that received feedback on their comments from government, ***this result indicates that a firm that provides comments, but feels those comments are not taken seriously by government, will actually be less likely to comply than a firm that does not comment at all.***

In Models 9 and 10, we combine our different variables for political participation in order to separate how participation's effect on compliance is shaped by government's response to it. The results offer a refined depiction of the results described above. The coefficient on *Provided Comment* is negative and highly significant ($p<0.05$) in both models. In interpreting this coefficient, it is important to understand that the presence of our other, stricter political participation variable, *Received Response*, within the same models means that the results on *Provided Comment* specifically refer to the effect on compliance of public comments that DID NOT receive any feedback from government.

This distinction is driven home by the fact that, in both of these two models, the coefficient on *Received Response* remains positive and statistically significant. As with *Provided Comment*, the size of the coefficient on *Received Response* also remains quite consistent with those in the subsample analyses. The statistical significance of *Received Response* does fall somewhat in Model 10 from its highly significant level in Model 9. This appears to be because of the very high correlation within our sample between *Received Response* and *Comment Used*.

Figure 3.8 illustrates the additive effects of the three levels of participation on regulatory compliance. The blue circles represent the coefficient for each of the three main variables, while the range bars depict 90% confidence intervals. The confidence intervals help us understand the plausible parameters for the analysis if we were to resample 1000 times and plot the distribution of outcomes. If the confidence interval crosses zero, it means that in repeated samples, we cannot rule out the possibility that there is no relationship between participation and compliance. The figure clearly shows that participation without a government response actually reduces compliance with the Labor Code. Firms that commented and received no acknowledgement employ 3% less workers with formal contracts than those who provided no comment at all. Firms that received acknowledgement, but whose comments were not used have an additional 4% more workers with formal contracts. Although just shy of statistical significance, if the government actually uses a comment in the final regulation, a firm will further comply with the law by placing 1.8% more workers under formal contract.

FIGURE 3.8 **Graphical Illustration of Regression Results (90% Confidence Intervals)**



Testing the Mechanism:

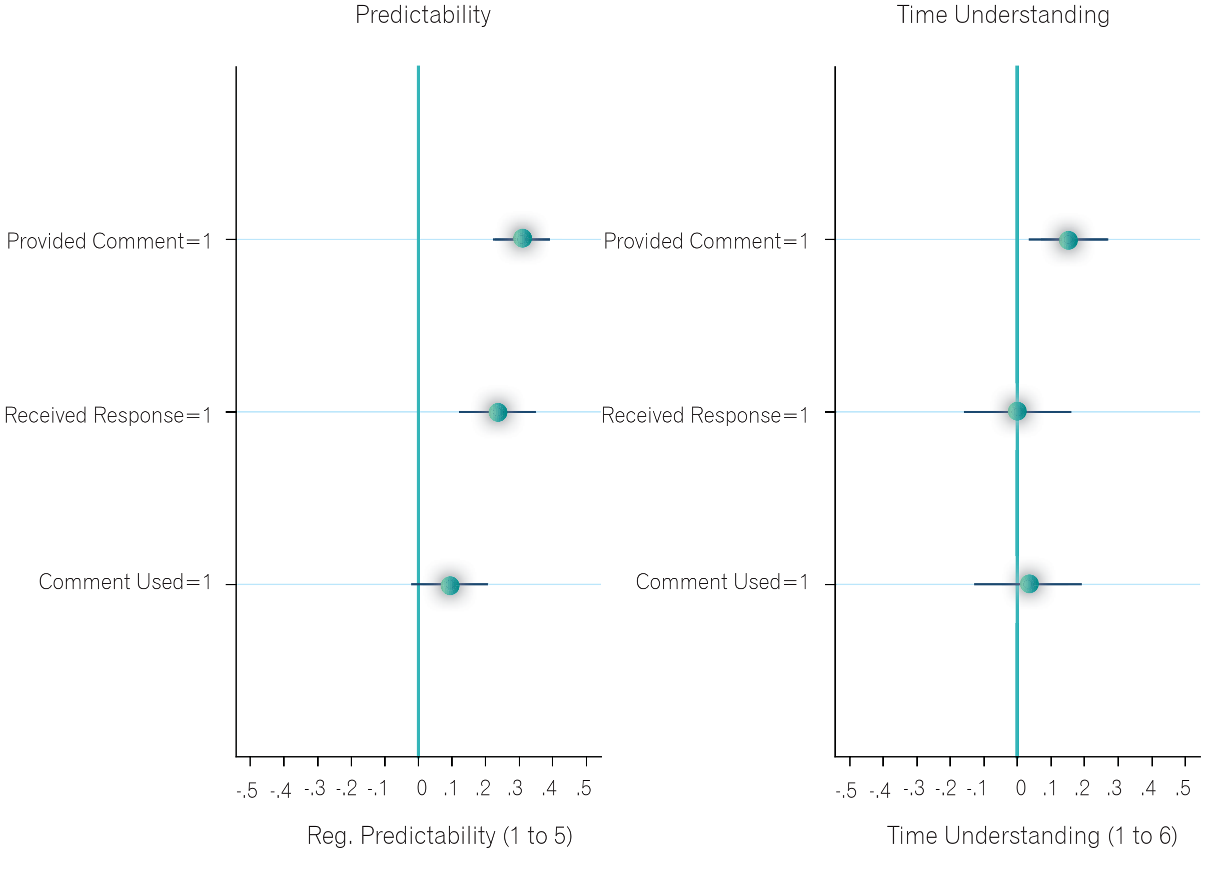
The above analysis gives us some confidence that participation improves compliance with the Labor Code. Nevertheless, we still do not know which of the proposed mechanisms is responsible for the change. Are firms abiding by the law, because participation allowed them to understand it better? Or are firms following the law, because participation gave them greater confidence in government actors and respect for the purpose of labor regulations.

Adjudicating these two mechanisms requires that we complete two more tests. First, we need to test the pathway between providing comments and the two respective mechanisms. Are firms that comment more likely to know more about regulation and believe the process has greater legitimacy? In statistical terms, we need to regress our measures of information (M1.1 & M1.2) and legitimacy (M2.1 & M2.2) on our three levels of public participation. Second, we need to assess the pathway between those two mechanisms and compliance with the law. Do firms that know more demonstrate greater compliance? Do firms that have more confidence in the process demonstrate greater compliance?

Beginning with first test, we replicate the same regressions we used in Table 3.3 (Model 10), but this time we substitute our measure of compliance for the tracers of the mechanisms. Although the full table is available upon request, for presentation purposes, we present only the coefficient graphs, controlling for all the variables stipulated above.

Using dependent variables for a firm's knowledge of government regulation in Figure 3.9, we find a positive relationship between political participation and firm knowledge accumulation. The graphic shows that the information benefit of even unacknowledged participation is particularly evident in terms of improving a firm's belief that it has the power to predict its regulatory environment. Firms that provided a comment have a 0.3 point higher prediction score on the five-point scale. If the government acknowledges the comment, the prediction score jumps an additional 0.24 points. And finally, when the comment is used, the prediction score increases marginally by 0.9 points. In other words, every successive level of participation has a strong impact on firm knowledge of the regulation. Similarly, in the second panel we observe that participating firms invest greater time in understanding the regulations in order to invest in compliance. Interestingly, receiving acknowledgement does not have a significant additional effect on this measure.

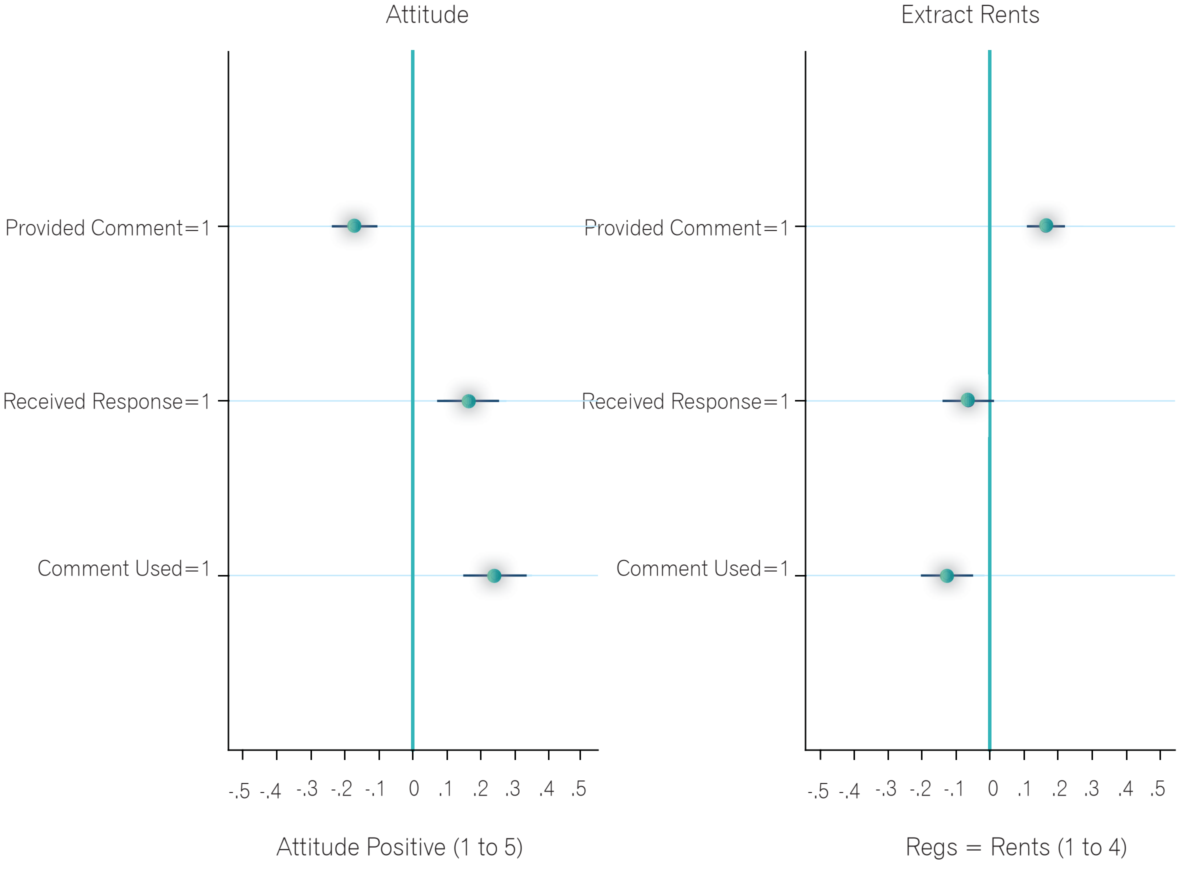
FIGURE 3.9 **Political Participation and Regulatory Knowledge (90% Confidence Intervals)**



We next move on to the second proposed mechanism, which is that participation increases confidence in government. In Figure 3.10 we see that an unacknowledged comment predicts a lower opinion of the provincial government's attitude towards private companies (-0.17 on the five-point scale) and a greater belief that regulations are abused by officials (0.16 on the four point scale).[67] In other words, comments without government acknowledgement are significantly associated with deterioration in business perceptions of government officials.

When a firm's comments are acknowledged, in contrast, this relationship between participation and the legitimacy of government is reversed for both measures (0.16 for attitude; -0.06 for rents, implying less abuse of regulations for personal gain). The belief by a firm whose comments were reflected in subsequent changes to the regulation has a further positive influence on the firm's expected perception of local government's view of the private sector, and even strong negative effect on abuse of regulations for rent extraction (0.24 for attitude; -0.12 for rents). Combined these two effects overpower the negative effects of unacknowledged participation.

FIGURE 3.10 **Political Participation and Confidence in Policy-Making (90% Confidence Intervals)**



67 We reversed the coding of this variable, so that higher scores mean agreement with the statement. Thus, the negative coefficient implies less abuse.

Finally, in the second test, we round out our investigation of the relationship between legislative participation, the mechanisms of regulatory knowledge and confidence in policy-makers, and regulatory compliance. To this end, we look at the degree to which the two mechanisms (information and legitimacy) predict compliance. Table 3.4 shows that our results are mixed.

On the one hand, although, participation is associated with more information about regulations, we find no evidence that a greater ability to predict regulatory implementation is associated with greater compliance with the labor code. The coefficient on our measure of predictability is effectively zero in Model 1.

On the other hand, however, consistent with our findings that only acknowledged comments were positive predictors of both greater compliance and of greater perceptions of government legitimacy, Model 2 indicates a strongly positive relationship between greater perceptions of government legitimacy and regulatory compliance. A one-point shift in the five-point attitude scale is associated with 3.8% more workers having formal contracts. Model 3 produces the related result that firms that were less likely to believe that rent-seeking is prevalent in the use regulations were also more likely to comply with regulations.[68] A one-point shift in the four-point scale, meaning a firm is more likely to associate regulations with informal fees, leads to a 3.6% reduction in the amount of contracted labor. Models 4 and 5 produce consistent results when combining these variables into the same regression.

TABLE 3.4 Test of Mechanisms: Correlation between Intermediate Variables and Compliance

Dependent Variable: Share of Full-Time Workers with Contracts	Information (1)	Legit 1 (2)	Legit 2 (3)	Combined 1 (4)	Combined 2 (5)
Key Independent Variables					
Preditability of Regulation (1 to 5)	0.388			0.252	0.403
	(0.424)			(0.429)	(0.444)
Attitude of Government (1 to 5)		3.804***		3.566***	
		(0.504)		(0.530)	
Regulation used to Extract Rents (1 to 4)			-3.610***		-4.290***
			(0.668)		(0.694)
Full Set of Controls	Yes	Yes	Yes	Yes	Yes
Sector FE	Yes	Yes	Yes	Yes	Yes
Province FE	Yes	Yes	Yes	Yes	Yes
Observations	5,110	5,436	5,066	4,964	4,675
R-squared	0.084	0.089	0.085	0.093	0.090
rmse	29.37	29.38	29.47	29.32	29.34

Standard errors, clustered at province level, in parentheses (*** p<0.01, ** p<0.05, * p<0.1)

[68] We reversed the coding of this variable, so that higher scores mean agreement with the statement. Thus, the negative coefficient implies less abuse.

3.6 DISCUSSION

> " While political participation leads to higher regulatory compliance by firms, this relationship can be reversed if the government is seen to be ignoring the input. "

The implications of these results are quite exciting. We find tentative empirical support for our theory about participation in the drafting of regulations in Vietnam. While political participation leads to higher regulatory compliance by firms, this relationship can be reversed if the government is seen to be ignoring the input. Furthermore, PCI data allows us to dig deeper and explore the mechanisms behind these findings. Consistent with research in political science about the benefits of participation at the individual level, we find evidence that participation in the drafting of regulations increases both knowledge about the regulatory framework and positive perceptions about the government seeking to implement it. Specifically, we find that firm-specific knowledge increases with deeper engagement with government, while the confidence in government benefits come about only when government appears to be an active partner. When government is not responsive, participating firms actually hold lower opinions of government than firms that do not participate at all.

The results motivate an important policy recommendation. Vietnam's *Law on Laws* does not currently require ministries to publically respond to comments submitted to them. It is also unclear how seriously online portals for commenting on draft regulations are monitored and absorbed by the government agencies with which they are associated. Consequently, many businesses believe they waste valuable time and energy when they study and respond to draft laws and regulations, because they expect their comments will ultimately be ignored. This engenders resentment and distrust, exactly the opposite of the intention behind efforts to institutionalize a participation process for businesses.

Skeptics about the benefits of participation do already exist. Some have railed against the "new tyranny," bemoaning the prevalence of participation in development without foundational logic or empirical support.[69] Less polemical authors have noted that theoretical work does not take into account the costs of participation or the underlying power relationships of the actors.[70] Less educated and poorer citizens and firms may find entry barriers (legal literacy) and opportunity costs of participation higher than others. Consequently, in a review of participatory programming, Mansuri and Rao (2012) found that participation tends to be dominated by those who are wealthier, more educated, of higher social status, male, and more politically connected than nonparticipants (p5). Not surprisingly, they also discovered that resulting policies are biased in favor of the elites that do

69 Cooke and Kothari 2001
70 Turner and Weninger 2005

participate. Worse still, others argue that, in practice, public participation procedures (such as public comment) are mere formalities, especially in less democratic settings where governments have little incentive to heed the public's input.[71]

Our findings offer tentative evidence, however, that when implemented correctly, institutionalized participation can offer real and important effects that benefit society.

3.7 LIMITATIONS

We present our findings cautiously, however, because of fairly substantial limitations to our research design. We wish to explicitly recognize these limitations and offer potential solutions for future work. Five problems currently limit our confidence in the above correlations.

1) Measurement of the dependent variable: Our analysis relies on survey questions that ask respondents if and how much they are currently complying or would comply with a particular regulation or legal norm (i.e. formal contracts, unions, abiding by environmental law, and paying taxes). These measures, however, introduce the possibility of social desirability bias with respondents reporting what they believe the interviewer wants to hear, rather than the true state of affairs.[72] This is a particularly pernicious problem when the dependent variable is legal compliance and the respondent risks punishment for a violation. It may be that we are over-estimating the amount of true compliance in ways that bias the association with participation.

2) Measurement of the independent variable. We study general participation across a range of policy arenas, because it is impossible to ask about specific regulations and types of participation on a general interest survey. This decision, however, makes it impossible to tie the particular participation that we care about to specific policy outcomes like the share of workers under formal contract.

3) Selection bias. As Mansuri and Rao (2012) demonstrate, self-selection into participation severely limits inference. Those mostly like to participate tend to be the biggest, best educated, and possess the best connections to policymakers, or are the best informed about policy change. These features, however, may be associated with downstream compliance. Thus, it is impossible to tell whether an association, demonstrates a causal relationship, or simply results from the selection process (e.g. those most likely to participate are also mostly likely to comply). According to Vietnam's MOLISA representatives, this has critical implications for their work enforcing regulations. The firms which are most likely to violate the law and put workers at risk, are the exact same firms that require the most effort and resources in educational and public comment campaigns.

[71] Tang et. al 2008.
[72] Holbrick and Krosnick 2010, Janus 2010.

4) The General Relationship: In our regressions, it is not clear from where confidence and trust arise. They are treated as exogenously assigned, rather than as resulting from a participatory process. At the end of the day, we have tantalizing evidence for pieces of the relationship, but limited confidence that a participation intervention will bring about our desired outcomes, i.e. greater safety of citizens and workers.

5) Which Mechanisms? We can rule out knowledge with some confidence, but we still don't know very much about the quality of law mechanism. Which theoretical mechanism is doing the work matters deeply for policy implications, but we have not narrowed down the results enough.

To resolve this impasse, the research team is currently designing a randomized control trial (RCT) to provide the first empirical test of the relationship between participation and regulatory compliance by businesses in emerging markets. VCCI already has significant experience in soliciting comments on business regulations through its own online portal and other direct means of communication with Vietnam's business community. Our project takes advantage of a process for public participation in the drafting of Vietnamese legislation, which was formalized in the 2008 LoL.

The RCT will analyze the downstream compliance of four randomly assigned groups of firms: 1) those simply receiving a presentation about the regulation; 2) those invited to provide comments on the draft regulation; 3) those invited, but also subsequently provided with some evidence that their comments will be carefully considered by the drafting committee; and 4) a control group not invited to participate, but instead receiving a placebo treatment of some sort.

After the final regulation is promulgated, the team will monitor the firms in all four groups to test their compliance with the final legislation. We will select a regulation for which compliance is readily observable, so that we will have clear evidence of whether participation led to downstream compliance and which of the three mechanisms is most responsible.

In short, our experiment will resolve all of the methodological limitations discussed above: 1) it provides a clear, objective measure of compliance; 2) it narrows the key causal variable to online participation; 3) it resolves selection bias through randomizing who has the opportunity to participate; 4) it resolves the endogeneity of legitimacy through a clear baseline measure of legitimacy before the participation intervention; and 5) It separates the mechanisms through a factorial design that assesses each of the different mechanisms separately.

The bottom line is that the PCI report provides a tantalizing hint that participation can have extremely beneficial effects that will improve economic efficiency, while improving the welfare of citizens and workers. The next step is to build scientifically on that relationship to understand exactly how to build the next generation of participatory institutions in Vietnam. This will allow us to make concrete recommendations relating to difficult decisions about how to best allocate scarce government resources to maximize social welfare.

APPENDIX

APPENDIX 1 Methodology Changes in the 2013 PCI

Item	Changes	Reason	Suggested by experts (Y/N)
Sub-index 1 – Entry			
1. Length of business registration in days (median)	None		
2. Length of business re-registration in days (median)	None		
3. Percentage of firms that need additional licenses/permits	***Dropped***	Not enough data to analyze	No
4. Number of licenses and permits necessary to start operations (median, after 2010)	***Dropped***	Not enough data to analyze	No
5. Median number of days to wait for Land Use Rights Certificate	None		
6. Percentage of firms waiting for more than one month to complete all steps necessary to start operations	None		
7. Percentage of firms waiting more than three months to complete all steps necessary to start operations.	None		
8. Percentage of firms registering or re-registering through one-stop-shop	*New indicator*	This indicator is added to measure to quality of One Stop Shops (OSS), which is a good measure of quality of the regulatory environment. OSS is being rolled out across provinces in Vietnam at different stages and quality levels. Therefore it is important for the PCI to reflect this movement.	No
9. Procedures at one-stop-shop are transparently listed (% Agree)	*New indicator*	*As above*	No
10. Procedures at one-stop-shop are transparently listed (% Agree)	*New indicator*	*As above*	No
11. Guidance and instruction on procedures at one-stop-shop are clear and adequate (% Agree)	*New indicator*	*As above*	No

Item	Changes	Reason	Suggested by experts (Y/N)
12. Staffs at one-stop-shop are professional and knowledgable (% Agree)	*New indicator*	As above	No
13. Staffs at one-stop-shop are friendly (% Agree)	*New indicator*	As above	No
14. IT application at one-stop-shop is good (% Agree)	*New indicator*	As above	No
Sub-index 2 – Land			
1. Percentage of firms that own land and are in possession of an LURC	None		
2. Percentage of land that has been registered and provided with official LURCs (MONRE)	None		
3. Percentage of firms that say nonstate enterprises do not have difficulties in accessing land or expanding premises	None		
4. Firms' rating of expropriation risk (from 1-Very High to 5-Very Low)	None		
5. Percentage of firms that say compensation for land is always or highly likely fair	None		
6. Percentage of firms that agree that changes in government land prices reflect changes in market prices	None		
7. Percentage of firms that have completed land procedures in the last two years and have encountered no difficulties in land-related procedures.	*New indicator*	This indicator is added to in order to capture the widely cited problems of difficult administrative procedures in land transactions that are faced by both businesses and individuals	No
8. Percentage of firms that want to have LURCs but don't have LURCs because of complicated procedures and troublesome staff.	*New indicator*	This indicator is included to reflect on detailed issues LURC applicants face when they consider applying for LURCs. The procedural complexity and behavior of bureaucrats behavior are key deterrents to obtaining LURCs.	No

Item	Changes	Reason	Suggested by experts (Y/N)
Sub-index 3 – Transparency			
1. Access to planning documents (1=easy to access; 5= impossible to access)	None		
2. Access to legal documents (1=easy to access; 5= impossible to access)	None		
3. Relationship important or very important to get access to provincial documents (% Important or Very Important)	None		
4. Negotiations with tax authority are an essential part of doing business (% Agree or Strongly Agree)	None		
5. Predictability of implementation of central laws at the provincial level (% Usually or Always)	None		
6. Firm gives comments on government regulation (%).	***Dropped***	Most comments are supplied by large or connected firms leading to confusion in interpretation.	
7. Business Association's role in advising and countering provincial polices (% Important or Very Important)	None		
8. Openness and quality of provincial webpages	Criteria for scoring provincial websites are replaced by new ones which include: forms, option for online submission, provincial gazette, option for two way	These are necessary changes to build a better indicator of website quality. This is also to encourage provinces to operate and make their website more interactive and meaningful to businesses. The broadened score range is used too	Yes

Item	Changes	Reason	Suggested by experts (Y/N)
9. Percentage of firms that have accessed provincial websites	*New indicator*	This indicator is added to capture the usefulness of provincial government's websites to businesses. As internet and websites are the most effective means of communication in an increasingly connected Vietnam.	No
10. Budget documents have enough details for use in business activities (% YES)	*New indicator*	This indicator is added to measure how transparent the local budgets are. This is very important to create a level playing field in Vietnam.	No
11. Budget documents are published right after being approved (% YES)	*New indicator*	*As above*	No
Sub-index 4 – Time Costs			
1. Percentage of firms spending over 10 percent of their time on understanding and complying with regulations	The term "contacting government officials" is dropped from the question D6 on which this indicator is based.	This is because it is said that "contacting government officials" is not only about complying with laws and regulations	Yes
2. Median number of inspections (all agencies)	None		
3. Median tax inspection hours	None		
4. Government officials are effective (% Strongly agree or Agree)	This question asks about officials' effectiveness only. In previous years the corresponding question asked about both effectiveness and friendliness at the same time. Multiple choice is replaced with a Likert scale.	We want to be more precise. Effectiveness and friendliness are two different and independent concepts. Multiple choice was unable to tell if respondents do not agree with a statement. If they agreed, it could not provide the extent of agreement.	No

Item	Changes	Reason	Suggested by experts (Y/N)
5. Government officials are friendly (% Strongly agree or Agree)	This question asks about officials' friendliness only. In previous years the corresponding question asked about both effectiveness and friendliness	*As above*	No
6. Firms don't have to travel many trips to obtain stamps and signatures (% Strongly agree or Agree)	Multiple choice is replaced by Likert scale	Multiple choice was unable to tell if respondents do not agree with a statement. If they agreed, it could not provide the extent of agreement.	No
7. Paperwork is simple (% Strongly agree or Agree) NEW INDICATOR	*As above*	*As above*	No
8. Fees are listed publically (% Strongly agree or Agree) NEW INDICATOR	*As above*	*As above*	No
9. No noticeable improvements are made (% Strongly agree or Agree)	*As above*	*As above*	No
Sub-index 5 – Informal charges			
1. Enterprises in my line of business usually have to pay for informal charges (% agree or totally agree)	None		
2. Percentage of firms paying over 10 percent of their revenue for informal charges	None		
3. Rent-seeking phenomenon is popular in handling administrative procedures for businesses (% strongly agree or agree)	None		

Item	Changes	Reason	Suggested by experts (Y/N)
4. Percentage of firms saying that informal charges usually or always deliver expected results	None		
5. Informal charges are at acceptable levels (% Strongly agree or Agree)	*New indicator*	This indicator is added to capture the level of corruption burden in relation to firms' ability to absorb it	
Sub-index 6 - Bias			
Sub-index 6 - Bias	*New sub-index*	This new sub-index is added to make the PCI more in tune with what is happening in the business environment in Vietnam. Experts raise the concerns that in recent years local governments have been favoring FIEs and large SOEs at the cost of nonstate enterprises. The broadenning of the PCI coverage is expected to promote a fairer business environment for domestic private firms who are becoming the economic locomotive of Vietnam	Yes
1. Province give privileges to state-owned economic group, corporations, causing difficulties to your business (% Agree)	*New indicator*	This indicator is added to measure firms' perception about provincial governments' preference for SOEs	Yes
2. Land access as a privilege to state-owned economic group (% agree)	*New indicator*	*As above*	Yes
3. Credit access as a privilege to state-owned economic group (% agree)		*As above*	Yes
4. Mineral exploitation license as a privilege to state-owned economic group (% agree)	*New indicator*	*As above*	Yes
5. Faster and simpler administrative procedures as a privilege to state-owned economic group (% agree)	*New indicator*	*As above*	Yes
6. Ease in getting state contracts as privilege to state-owned economic group (% agree)	*New indicator*	*As above*	Yes
7. Province give priority in solving problems and difficulties to foreign companies over domestic one (% agree)	*New indicator*	This indicator is added to measure firms' perception about provincial governments' preference for FIEs	Yes

Item	Changes	Reason	Suggested by experts (Y/N)
8. Province give priority to FDI attraction than private sector development (% agree)	*New indicator*	*As above*	Yes
9. Advantage in land access for FIEs (% agree)	*New indicator*	*As above*	Yes
10. CIT reduction and holiday for FIEs (% agree)	*New indicator*	*As above*	Yes
11. Advantage in procedures (faster, simplifier) for FIEs (% agree)	*New indicator*	*As above*	Yes
12. More government support during FIE operation (% agree)	*New indicator*	*As above*	Yes
13. "Contracts, land, …, and other economic resources mostly fall in the hands of enterprises that have strong connections to local authorities" (% agree)	*New indicator*	This indicator is added to measure firms' perception about provincial governments' preference for big and well-connected firms, either state-owned or private	Yes
14. Preferential treatment to big companies (both state-owned and nonstate) is an obstacle to their business operations (% agree)	*New indicator*	*As above*	Yes
Sub-index 7 – Proactivity			
1. Firms' assessment of the attitude of provincial government toward private sector (% Very Positive or Very Positive)	None		
2. The PPC is flexible within the legal framework to create favorable business environment for nonstate firms (% Strongly Agree or Agree)	None		
3. The PPC is very proactive and innovative in solving new problems (% Strongly Agree or Agree)	None		
4. There are good initiatives at the provincial level but they are not well implemented by departments (% Strongly Agree or Agree)	*New indicator*	This indicator is added to measure the effectiveness of provincial governments in guiding and governing the policy and regulations implementation at the department level. In the process of decentralization, departments are now empowered to handle many administrative procedures and implement policies in provinces.	Yes

Item	Changes	Reason	Suggested by experts (Y/N)
5. Provincial leaders have good policies they are not well implemented at district level (% Strongly Agree or Agree).	*New indicator*	This indicator is added to measure the effectiveness of provincial governments in guiding and governing policy and regulations implementation at the district level. In the process of decentralization, district governments are now empowered to handle many administrative procedures and implement policies in provinces.	Yes
6. Province's reaction to lack of clarity in central policies/ documents: % "delay and seek instructions" and "do nothing"	*New indicator*	This indicator is added to measure the proactivity of local authorities in clarifying central regulations to make it easier for local businesses to comply.	No
Sub-index 8 – Business Support Services			
1. Number of trade fairs held by province in previous year and registered for present year (Ministry of Industry and Trade)	None		
2. Ratio of the number of service providers to the total number of firms (General Department of Taxation data)	None		
3. Ratio of the number of non-state and FDI service providers to the total number of service providers (General Department of Taxation data)	None		
4. Firm has used business information search services (%) (e7_1_1)	None		
5. Firm used private provider for business information search services (%)	None		
6. Firm intends to use business information search services again (%)	None		
7. Firm has used consulting on regulatory information (%)	None		
8. Firm used private provider for consulting on regulatory information (%)	None		
9. Firm intends to use regulatory consulting services again (%)	None		

Item	Changes	Reason	Suggested by experts (Y/N)
10. Firm has used business match making services(%)	None		
11. Firm used private provider for business match making services (%)	None		
12. Firm intends to use business match making services again (%)	None		
13. Firm has used trade promotion services (%)	None		
14. Firm used private provider for trade promotion services (%)	None		
15. Firm intends to use trade promotion services again (%)	None		
16. Firm has used technology related services (%)	None		
17. Firm used private provider for technology related services (%)	None		
18. Firm intends to use above service provider again for technology related services (%)	None		
19. Firm has used accounting and financing training services (%)	*New indicator*	This indicator is added to measure the effectiveness of their province's policies in promoting the accounting and financing training services which are very important for business development	Yes
20. Firm used private provider for above accounting and financing training services (%)	*New indicator*	As above	Yes
22. Firm intends to use the accounting and financing training services again (%)	*New indicator*	As above	Yes
23. Firm has used business administration training services (%)	*New indicator*	This indicator is added to measure the effectiveness of their province's policies in business administration training services which are very important for business development	Yes
24. Firm used private provider for above business administration training services (%)	*New indicator*	As above	Yes
25. Firm intends to use the business administration training services again (%)	*New indicator*	As above	Yes

Item	Changes	Reason	Suggested by experts (Y/N)
Sub-index 9 – Labor quality			
1. Services provided by provincial agencies - general education (% Very Good or Good)	None		
2.Services provided by provincial agencies – vocational training (% Very Good or Good)	None		
3. Firm has used labor exchange services (%)	None		
4. Firm used private provider for above labor exchange services (%)	None		
5.Firm intends to use labor exchange services again (%)	None		
6.Percentage of total business costs spent on labor training	None		
7. Percentage of total business costs spent on labor recruitment	None		
8. Overall Satisfaction with Labor (% Agreeing labor meets firm needs)	None		
9. Ratio of vocational training school graduates to untrained laborers (MOLISA)	None		
10. Secondary school graduates as % of workforce (MOLISA)	None		
11. Percentage of workers having completed training at vocational schools	*New indicator*	This indicator is added to better measure the quality of workforce. The data provided by MOLISA may be far from reality of firms, especially SMEs.	Yes
Sub-index 10 – Legal institutions			
1. Legal system provided mechanism for firms to appeal against officials' corrupt behavior (% Always or Usually)	None		
2. Firm confident that legal system will uphold property rights and contracts (%Strongly Agree or Agree)	None		

Item	Changes	Reason	Suggested by experts (Y/N)
Business used courts or other legal institutions to resolve disputes (%)	***Dropped***	Not enough data to analyze	No
3. Cases filed by by non-state entities at Provincial Economic Courts per 100 firms (Supreme Court)	None		
4. Non-state claimants as a percentage of claimants at Provincial Economic Courts (Supreme Court)	None		
Median months to resolve court cases	***Dropped***	Not enough data to analyze	No
Median formal and informal costs as a percentage of case	***Dropped***	Not enough data to analyze	No
5. Provincial court judge economic cases by the law (% Agree or Strongly Agree)	*New indicator*	This indicator is added to measure the quality of juridical services with regard to commercial disputes	Yes
6.Provincial court resolve economic cases quickly (% Agree or Strongly Agree)	*New indicator*	*As above*	Yes
7. Court judgments are enforced quickly (% Agree or Strongly agree)	*New indicator*	*As above*	Yes
8. Legal aid agencies support business to use laws to sue when disputes arise (% Agree)	*New indicator*	*As above*	Yes
9.Formal and informal costs are acceptable (% Agree or Strongly Agree)	*New indicator*	*As above*	Yes
10.Judgement by the court is fair (% Agree or Strongly Agree)	*New indicator*	*As above*	Yes
11.Willingness to use court in case a dispute arises (% Yes)	*New indicator*	*As above*	Yes
Weighting scheme			
Weighting scheme	A new weighting scheme is used to create the PCI 2013	This year a new sub-index (Bias) is added to the PCI and the old weighting scheme, which was estimated in 2009, is outdated now.	No

APPENDIX 2 Infrastructure Index

TABLE A2.1 Infrastructure Index and Sub-Indexes - Benchmarking

Province	Overall Infrastructure Score	Infrastructure, DTF*	IZ score	IZ, DTF	Roads score	Roads, DTF	Engery-Telecom score	Energy-Telecom, DTF	Internet score	Internet, DTF
Da Nang	74.49	100	15.73	74.93	18.93	100	19.48	100	20.35	95.77
Binh Duong	73.03	98.04	20.99	100	17.83	94.19	15.31	78.57	18.91	88.98
BRVT	72.68	97.57	16.91	80.59	18.39	97.15	16.96	87.03	20.42	96.11
Bac Ninh	69.80	93.71	17.89	85.26	16.40	86.65	18.07	92.74	17.44	82.08
HCMC	69.73	93.61	18.21	86.77	13.61	71.91	16.66	85.50	21.25	100
TT-Hue	68.42	91.85	15.49	73.79	16.55	87.47	18.35	94.17	18.03	84.84
Dong Nai	66.71	89.56	20.40	97.22	15.58	82.34	16.41	84.25	14.30	67.32
Thai Binh	66.23	88.92	14.74	70.26	16.87	89.15	16.01	82.20	18.60	87.52
Quang Ninh	65.81	88.35	14.45	68.84	15.90	84.00	18.31	93.99	17.15	80.73
Hai Duong	65.61	88.08	15.70	74.83	16.81	88.81	15.16	77.81	17.94	84.41
Long An	63.98	85.89	20.88	99.49	12.72	67.23	15.35	78.81	15.02	70.67
Vinh Long	63.87	85.75	14.27	68.01	15.01	79.29	15.51	79.58	19.09	89.81
Vinh Phuc	63.82	85.68	14.19	67.62	16.27	85.97	14.69	75.38	18.67	87.87
Nam Dinh	63.75	85.58	12.39	59.05	17.94	94.80	14.83	76.14	18.58	87.42
Binh Dinh	62.87	84.40	11.43	54.46	16.52	87.30	15.11	77.58	19.80	93.18
Tien Giang	62.20	83.50	13.67	65.16	15.87	83.84	17.62	90.44	15.04	70.76
Hau Giang	62.09	83.36	13.88	66.14	15.57	82.25	14.50	74.43	18.14	85.38
Hai Phong	61.76	82.91	11.82	56.33	14.60	77.15	17.38	89.21	17.95	84.48
Ben Tre	61.20	82.16	11.56	55.06	17.70	93.50	16.33	83.83	15.62	73.49
Soc Trang	61.06	81.98	12.55	59.80	15.32	80.97	15.71	80.62	17.48	82.27
Dak Lak	60.69	81.47	9.92	47.25	15.91	84.04	16.00	82.10	18.87	88.80
Ha Noi	60.57	81.32	13.49	64.27	14.86	78.50	13.96	71.65	18.27	85.96

Province	Overall Infrastructure Score	Infrastructure, DTF*	IZ score	IZ, DTF	Roads score	Roads, DTF	Engery-Telecom score	Energy-Telecom, DTF	Internet score	Internet, DTF
Ninh Binh	60.52	81.25	13.25	63.12	15.59	82.38	15.73	80.72	15.96	75.09
Can Tho	60.27	80.91	11.86	56.52	13.79	72.86	18.11	92.94	16.51	77.68
Khanh Hoa	60.26	80.90	11.18	53.26	15.50	81.89	16.60	85.21	16.98	79.93
Dong Thap	59.62	80.05	11.99	57.12	14.87	78.59	15.79	81.06	16.97	79.86
Ninh Thuan	59.38	79.71	11.32	53.93	14.00	73.97	15.09	77.46	18.96	89.25
Quang Ngai	58.66	78.76	11.42	54.43	14.22	75.14	14.88	76.37	18.14	85.36
Thanh Hoa	58.02	77.90	11.96	56.98	13.38	70.68	16.33	83.83	16.36	76.98
Phu Yen	57.87	77.69	8.59	40.91	13.54	71.52	17.26	88.57	18.49	87.00
Kon Tum	57.83	77.63	10.42	49.65	13.08	69.13	16.91	86.82	17.41	81.92
Ha Tinh	57.69	77.45	12.31	58.66	14.10	74.48	15.02	77.10	16.26	76.51
Tra Vinh	57.51	77.20	12.54	59.78	13.21	69.81	15.88	81.50	15.87	74.68
Ha Nam	57.41	77.07	12.08	57.59	14.03	74.12	15.08	77.41	16.21	76.30
Lao Cai	57.22	76.82	10.67	50.87	13.65	72.14	17.99	92.33	14.90	70.13
Nghe An	56.88	76.36	10.37	49.41	14.16	74.81	15.56	79.86	16.79	79.01
Kien Giang	56.07	75.28	14.89	70.96	9.98	52.74	14.82	76.06	16.38	77.07
Thai Nguyen	56.00	75.18	9.77	46.57	14.63	77.31	14.57	74.76	17.03	80.13
Phu Tho	55.60	74.65	8.81	42.00	13.86	73.21	14.54	74.62	18.40	86.58
Tay Ninh	55.35	74.31	13.30	63.36	14.41	76.11	13.87	71.17	13.78	64.85
Bac Lieu	55.18	74.09	12.12	57.73	12.51	66.11	15.74	80.81	14.81	69.71
Gia Lai	54.88	73.68	10.19	48.56	12.19	64.40	15.58	79.95	16.93	79.66
Dien Bien	54.75	73.50	10.81	51.50	11.53	60.95	15.60	80.10	16.80	79.06
Binh Thuan	54.66	73.38	9.34	44.51	12.58	66.45	15.62	80.19	17.12	80.56
Quang Binh	54.19	72.76	11.72	55.86	13.96	73.77	13.28	68.17	15.23	71.65

Province	Overall Infrastructure Score	Infrastructure, DTF*	IZ score	IZ, DTF	Roads score	Roads, DTF	Engery-Telecom score	Energy-Telecom, DTF	Internet score	Internet, DTF
Quang Tri	54.04	72.55	10.46	49.82	11.34	59.90	14.37	73.74	17.88	84.13
Quang Nam	53.71	72.11	12.39	59.03	14.53	76.79	13.91	71.38	12.88	60.61
Ca Mau	53.49	71.81	13.26	63.19	14.32	75.68	14.86	76.27	11.05	51.99
Binh Phuoc	53.46	71.78	10.12	48.22	12.11	63.99	16.27	83.51	14.96	70.42
Lam Dong	53.45	71.76	9.89	47.15	12.30	64.99	15.12	77.59	16.14	75.94
An Giang	53.01	71.17	8.41	40.07	12.87	67.98	15.05	77.24	16.69	78.52
Hung Yen	52.99	71.14	12.77	60.83	14.80	78.18	13.46	69.10	11.96	56.30
Cao Bang	52.40	70.35	8.22	39.18	10.92	57.71	15.57	79.92	17.68	83.22
Lai Chau	52.34	70.26	12.92	61.57	12.90	68.14	13.45	69.06	13.07	61.48
Lang Son	51.16	68.68	7.77	37.01	9.81	51.84	16.07	82.50	17.51	82.39
Ha Giang	50.73	68.11	7.11	33.86	13.73	72.54	15.81	81.15	14.09	66.29
Hoa Binh	49.50	66.45	9.25	44.10	11.25	59.44	13.97	71.72	15.02	70.69
Son La	49.33	66.22	6.10	29.07	11.04	58.35	16.15	82.91	16.03	75.42
Bac Kan	48.49	65.10	6.73	32.07	12.19	64.40	17.29	88.73	12.28	57.80
Yen Bai	48.06	64.53	8.05	38.34	11.25	59.45	14.20	72.88	14.57	68.55
Bac Giang	44.29	59.46	7.70	36.69	9.33	49.31	13.61	69.86	13.64	64.20
Dak Nong	42.36	56.87	6.95	33.10	10.71	56.61	11.71	60.13	12.99	61.11
Tuyen Quang	38.23	51.33	5.00	23.83	9.62	50.83	11.12	57.06	12.49	58.80

* DTF means distance to frontier which varies from 0 to 100 with 100 being the best province

Methodological notes: The Infrastructure Index is simple average of four sub-indexes which include: (i) Roads; (ii) Energy and Telecommunications; (iii) Industrial Zones and Parks; (iv) Internet. Detailed indicators which are used to create these sub-indexes are presented in the Table A2.2 below.

APPENDIX 3 Indicators used in Infrastructure Index

TABLE A2.1 Indicators Used in Infrastructure Index

Sub-Index	Indicator	Source	Measure	2009	2010	2011	2013
IZ Quality and Coverage	Number of IZs in province	Ministry of Planning and Investment (MPI) (August 2007)	Min	0	0	0	0
			Median	1	2	3	3
			Max	23	29	30	34
			Correlation w/ Previous Year	0.95*	0.92*	NA	0.97*
	Percentage of total IZ surface area that currently has occupants	MPI (August 2007)	Min	0.00	0.00%	0.00%	Not available
			Median	30.84	86.38%	53.07%	
			Max	93.55	100.00%	100.00%	
			Correlation w/ Previous Year	0.97*	0.27*		
	Firm rating of provinical IZ quality (% very good or good)	PCI Survey Question: E1.5	Min	0.00%	3.85%	15.56%	13.11%
			Median	24.07%	24.53%	39.34%	40.00%
			Max	79.17%	76.86%	77.78%	70.09%
			Correlation w/ Previous Year	0.75*	0.77*	0.43*	0.47*
	Assessment of road quality (% good or very good)	PCI Survey Question: E1.1	Min	7.95%	11.11%	15.85%	9.88%
			Median	28.80%	30.56%	39.74%	46.43%
			Max	80.82%	79.66%	79.56%	86.79%
			Correlation w/ Previous Year	0.84*	0.86*	0.64*	0.58*

Sub-Index	Indicator	Source	Measure	2009	2010	2011	2013
Road Quality and Transport Costs	Percentage of roads asphalted (national, provincial, or district levels)	GSO	Min	4.82	4.8	7.04	Same as 2011**
			Median	51.44	55.7	100.0	
			Max	100.00	100.0	100.0	
			Correlation w/ Previous Year	0.75*	0.76*	0.13*	
	Percentage of roads in provincially managed roads that are paved with asphalt	GSO	Min	3.00	3.0	34.3	Same as 2011**
			Median	69.65	80.9	84.8	
			Max	100.00	100.0	100.0	
			Correlation w/ Previous Year	NA	0.72*	0.65*	
	Number of days annually that roads are impassable due to rainfall	PCI Survey Question E2	Min	N.A	N.A	N.A	1.35
			Median				4.3
			Max				41.0
			Correlation w/ Previous Year				0.17
	Hours of telecommunications outages in the per month	PCI Survey Question E6	Min	0	6	0	0
			Median	3	10	0	0
			Max	8	21	2	5
			Correlation w/ Previous Year	0.25	-0.10	-0.16	-0.05

Sub-Index	Indicator	Source	Measure	2009	2010	2011	2013
Utilities (Energy and	Assessment of telecommunications quality (% good or very good)	PCI Survey Question E1.2	Min	35.59	44.87%	42.50%	44.71%
			Median	67.50	69.39%	70.83%	75.28%
			Max	84.93	90.00%	86.42%	89.00%
			Correlation w/ Previous Year	0.70*	0.69*	0.47*	0.49*
	Telephones (land and cellular) per 1,000 citizens	Ministry of Post and Telecommunciations	Min	0.4	85.1	81.5	4.6
			Median	1.9	205.9	201.7	11.8
			Max	20.8	385.8	418.7	31.3
			Correlation w/ Previous Year	0.12*	0.11	0.93*	0.52*
	Average cost per kilowat of energy in province (VND)	Electricity Vietnam (EVN)	Min	142.24	641.67	476.01	673
			Median	796.24	916.42	991.13	1125
			Max	1231.13	1423.75	1652.00	1495
			Correlation w/ Previous Year	0.44*	0.13*	N/A	0.35*
	Hours of electricity outages in the last month	PCI Survey Question E4	Min	46.00	24.00	0.00	0.00
			Median	50.00	89.00	9.66	8.00
			Max	58.00	150.00	24.00	13.86
			Correlation w/ Previous Year	−0.36	0.55*	0.20	0.15

Sub-Index	Indicator	Source	Measure	2009	2010	2011	2013
	Firms informed in advance about power cuts (% of time)	PCI Survey Question E5	Min	45.78	49.80	50.00	40.00
			Median	50.00	59.00	68.75	58.78
			Max	58.38	95.00	100.00	90.00
			Correlation w/ Previous Year	NA	0.32*	0.39*	0.01
Internet	Respondent posesses email address (%)	PCI Survey Question E7	Min	9.6%	13.9%	12.2%	19.1%
			Median	27.3%	34.1%	31.8%	42.6%
			Max	69.7%	73.5%	55.3%	65.2%
			Correlation w/ Previous Year	NA	0.80*	0.69*	0.30*
	Assessment of internet quality (% good or very good)	PCI Survey Question E1.6	Min	19.2%	20.29%	33.77%	35.71%
			Median	46.4%	48.18%	56.25%	65.33%
			Max	67.4%	69.19%	84.13%	81.94%
			Correlation w/ Previous Year	NA	0.62*	0.18*	0.32*

APPENDIX 4

We use a two-stage non-linear least squares (NLS) estimation model developed by Blaire and Imai (2012). This method uses a set of covariates to model non-sensitive responses in the control group and then uses this model to estimate response for the treatment group. The Imai process involves fitting a model to describe the control group, then using the estimated coefficients to predict new values for the treated group, as described below.

$Y_i = f(X_i\gamma) + T_i(X_i\delta) + \varepsilon_i,$ *where:*

- Y_i : response variable (total number of activities),
- T_i : treatment variable (received survey with sensitive item),
- X_i : matrix of covariates,
- $f(X_i\gamma)$: model for non-sensitive items (negative binomal regression),
- $g(X_i\delta)$: model for sensitive items (non-linear least squares).

We fit the $f(X_i\gamma)$ model to the control group via negative binomial estimation (to account for count nature of the data and the over-dispersion caused by zero answers) in the first stage. From this we obtain relationship between the response on the nonsensitive questions and each independent variable ($\hat{\gamma}$). Then we fit the $g(X_i\delta)$ model in the second stage using non-linear least squares (NLS). Then after subtracting $f(X_i\hat{\gamma})$ from Y_i we have a measure for the relationship between participating in the sensitive behavior and each independent variable ($\hat{\delta}$).[73]

[73] Standard errors are calculated using bootstrapping with 1,000 replications.

TABLE A1 Comparison of Entry Costs Sub-Index (2005-2013)

Indicator	Source (2013 Survey)	Measure	2005	2006	2007	2008	2009	2010	2011	2012	2013
Length of business registration in days (Median).	PCI Survey Question: C1	Min		12	7	5	6.5	7	7	7	7
		Median		20	15	12.25	10	10	8.5	10	10
		Max		58	22.5	15	15	15	15	15	17.5
		Correlation w/ Previous Year		NA	0.27*	0.46*	0.56*	0.49*	0.41*	0.52*	0.48*
Length of business re-registration in days (Median).	PCI Survey Question: C2	Min		6	3	3	3	2.5	3	3	3
		Median		10	7	7	7	7	7	7	7
		Max		35	15	10	10	12.5	14.5	15	7
		Correlation w/ Previous Year		NA	0.24*	0.53*	0.67*	0.48*	0.29*	0.24	0.29*
Percentage of firms that need additional licenses/permits	PCI Survey Question: C4_2010	Min						1.43	0	0.000	
		Median						14.68	12.9	9.52	
		Max						33.33	37.2	50	DROP
		Correlation w/ Previous Year						NA	0.26	0.18	
Median number of licenses and permits necessary to start operations after 2010	PCI Survey Question: C4	Min		2	1	1	0	1	1	1	
		Median		4	2.5	2	1	2	1.05	1.02	
		Max		7.5	5	4	3	4	1.34	1.18	DROP
		Correlation w/ Previous Year		NA	0.15	0.31	0.32*	0.03	N.A	0.15	
Median number of days to wait for Land Use Rights Certificate	PCI Survey Questions: B4.2	Min		40	30	30	15	20	15	15	15
		Median		121	60	38.5	32.5	30	30	30	30
		Max		338	180	105	180	150	90	105	240
		Correlation w/ Previous Year		NA	0.16	0.43*	0.23*	0.26*	0.12*	0.18	0.12
Percentage of firms waiting for more than one month to complete all steps necessary to start operations	PCI Survey Question: C5	Min	9.76	3.23	5.18	6.67	3.84	0	0	0	0
		Median	33.33	25.81	27.21	21.91	19.35	24.39	14.7	13.95	16.67
		Max	63.41	44	53.8	39.13	38.46	39.62	33.3	42.42	45.45
		Correlation w/ Previous Year	NA	0.24	0.26*	0.15	0.09	0.39*	0.08*	0.2	0.03
Percentage of firms waiting more than three months to complete all steps necessary to start operations.	PCI Survey Question: C5	Min	0	0	0	0	0	0	0	0	0
		Median	5.9	5.78	6.78	5.72	4.44	5.77	3.33	2.94	3.57
		Max	21.95	25.64	27.27	16	20.72	18.87	14.8	13.04	18.18
		Correlation w/ Previous Year		0.02	0.15	0.18	0.02	0.14	0.02*	0.04	0.15

Percentage of firms registering or re-registering through one-stop-shop. NEW INDICATOR	PCI Survey Question: C3	Min									41.58
		Median									63.41
		Max									85.71
		Correlation w/ Previous Year									0.18
Procedures at one-stop-shop are transparently listed (% Agree) NEW INDICATOR	PCI Survey Question: C3.1.1	Min									21.43
		Median									39.02
		Max									66.20
		Correlation w/ Previous Year									N.A
Guidance and instruction on procedures at one-stop-shop are clear and adequate (% Agree) NEW INDICATOR	PCI Survey Question: C3.1.2	Min									26.67
		Median									41.14
		Max									66.90
		Correlation w/ Previous Year									N.A
Staffs at one-stop-shop are professional and knowledgable (% Agree) NEW INDICATOR	PCI Survey Question: C3.1.3	Min									10.61
		Median									25.52
		Max									56.38
		Correlation w/ Previous Year									N.A
Staffs at one-stop-shop are friendly (% Agree) NEW INDICATOR	PCI Survey Question: C3.1.4	Min									10.61
		Median									24.71
		Max									56.38
		Correlation w/ Previous Year									N.A
IT application at one-stop-shop is good (% Agree) NEW INDICATOR	PCI Survey Question: C3.1.5	Min									3.91
		Median									16.07
		Max									44.68
		Correlation w/ Previous Year									N.A
None of the statements above are true (% Agree) NEW INDICATOR	PCI Survey Question: C3.1.6	Min									0.00
		Median									1.70
		Max									8.94
		Correlation w/ Previous Year									N.A

* Significant at 5% level; NA = Not applicable
All values are at the provincial level.
Data include only firms registered within two calendar years preceding the survey.
2005 data only include 42 provinces and do not include the full set of indicators used in subsequent years, reflecting changes in survey questions and ordering in 2006.

TABLE A2 Comparison of Land Access and Tenure Security Sub-Index (2005-2013)

Indicator	Source (2013 Survey)	Measure	2005	2006	2007	2008	2009	2010	2011	2012	2013
Percentage of firms that own land and are in possession of an LURC	PCI Survey Question: B4	Min		23.29	51.35	38.36	46.82	26.67	34.04	54.32	50.91
		Median		55.28	75.57	81.16	73.68	72.89	77.55	75.86	76.54
		Max		77.78	92.45	94.74	94.51	95.89	97.05	93.59	88.57
		Correlation w/ Previous Year			0.76*	0.70*	0.77*	0.80*	0.67*	0.49*	0.56*
Percentage of land that has been registered and provided with official LURCs	Ministry of Natural Resources and the Environment Datasets†	Min		11.3	13.28	19.52	23.52	27.27	42.82	29.22	76.50
		Median		69.2	63.13	77.56	77.89	80.71	79.24	82.21	90.50
		Max		96.5	97.46	98.75	98.56	98.31	98.03	97.65	99.40
		Correlation w/ Previous Year			0.85*	0.78*	0.87*	0.87*	0.73*	0.85*	0.30*
Percentage of firms that say nonstate enterprises do not have difficulties in accessing land or expanding premises	PCI Survey Question: B7	Min					11.02	8.27	12.2	11.25	16.13
		Median					30.72	23.89	30	31.32	39.50
		Max					52.32	49	68.5	52.89	58.44
		Correlation w/ Previous Year					NA	0.42*	0.23	0.26*	0.14
Firms' rating of expropriation risk (1: Very High to 5: Very Low);	PCI Survey Question: B4.3	Min		1.95	1.74	1.63	2.11	1.91	1.86	2.16	2.05
		Median		2.49	2.24	2.04	2.55	2.56	2.90	2.71	2.80
		Max		3.05	2.57	2.49	3.05	3.30	3.35	3.22	3.59
		Correlation w/ Previous Year			0.28*	0.95*	0.29*	0.31*	-0.0035	-0.1619	0.15
Percentage of firms that say compensation for land is always or highly likely fair	PCI Survey Question: B4.4	Min		21.43	22.22	21.25	16.9	19.12	14.7	12.95	22.78
		Median		40	40.76	38.82	40.54	39.9	35.8	36.67	40.32
		Max		58.33	57.14	52.75	55.17	55.38	61.8	69.23	68.66
		Correlation w/ Previous Year			0.37*	0.34*	0.42*	0.37*	0.17	0.18	-0.05
Percentage of firms that agree that changes in government land prices reflect changes in market prices	PCI Survey Question: B5	Min					53.33	53.91	41.9	36.02	60.00
		Median					69.75	72	68	69.57	77.06
		Max					81.11	86.17	86.2	87.64	89.87
		Correlation w/ Previous Year					NA	0.43*	0.36*	0.14	0.29*
Percentage of firms that have completed land procedures in the last two years and have encountered no difficulties in land-related procedures NEW INDICATOR	PCI Survey Question: B6.1	Min									21.74%
		Median									44.44%
		Max									73.33%
		Correlation w/ Previous Year									N.A
Percentage of firms that want to have LURCs but don't have LURCs because of complicated procedures and troublesome staffs NEW INDICATOR	PCI Survey Question: B4.5	Min									3.03
		Median									16.13
		Max									50.00
		Correlation w/ Previous Year									N.A

* Significant at 5% level; NA = Not applicable
All values are at the provincial-level.
2005 data only include 42 provinces and do not include the full set of indicators used in subsequent years, reflecting changes in survey questions and ordering in 2006.
† The Ministry of Natural Resources and the Environment changed the calculation of LURCs between 2003 and 2007 in the 5 national-level cities, leading to major reductions. To address this the old calculation was applied to cities.

TABLE A3 Comparison of Transparency Sub-Index (2005-2013)

Indicator	Source (2013 Survey)	Measure	2005	2006	2007	2008	2009	2010	2011	2012	2013
Access to planning documents (1=easy to access; 5= impossible to access)	PCI Survey Question: F1.1-F1.13†	Min	1.90	2.25	2.20	2.25	2.13	2.00	2.28	1.81	2.17
		Median	2.36	2.63	2.51	2.55	2.44	2.31	2.51	2.39	2.61
		Max	3.80	3.17	2.96	2.79	3.08	2.62	2.97	3.14	3.31
		Correlation w/ Previous Year	NA	0.39*	0.64*	0.61*	0.49*	0.48*	0.23	0.29*	-0.18
Access to legal documents (1=easy to access; 5= impossible to access)	PCI Survey Question: F1.1-F1.13†	Min	2.05	2.86	2.63	2.80	2.68	2.79	2.57	1.98	2.57
		Median	2.81	3.15	3.05	3.11	3.11	3.05	3.03	2.84	3.14
		Max	3.71	3.53	3.38	3.36	3.61	3.44	3.83	3.38	3.59
		Correlation w/ Previous Year	NA	0.31*	0.61*	0.59*	0.38*	0.56*	0.55*	0.32*	0.17
Relationship important or very important to get access to provincial documents (% Important or Very Important)	PCI Survey Question: F2	Min	50	31.48	38.4	33.57	45.57	37.28	41.17	29.73	30.33
		Median	72.11	62.5	56.6	49.82	61.26	78.64	75.00	62.20	51.47
		Max	100	77.14	73.4	67.9	78.26	95.71	93.33	82.69	74.68
		Correlation w/ Previous Year	NA	0.27	0.38*	0.55*	0.37*	0.30*	-0.05	0.18	0.21
Negotiations with tax authority are an essential part of doing business (% Agree or Strongly Agree)	PCI Survey Question: D14.3	Min	52.17	47.17	24.1	17.39	29.69	23.75	7.69	14.53	17.98
		Median	75.22	61.05	44.7	36.71	41.32	40.78	41.09	39.21	39.44
		Max	96.15	86.96	73.2	54,25	62.4	67.04	62.67	67.78	62.60
		Correlation w/ Previous Year	NA	-0.16	0.52*	0.73*	0.36*	0.27*	0.09	0.37*	-0.16
Predictability of implementation of central laws at the provincial level (% Usually or Always)	PCI Survey Question: F6	Min	4.35	2.76	1.89	1.03	3.57	2.38	0.00	1.30	1.35
		Median	14.91	9.49	7.96	6.94	8.4	8.97	8.57	6.60	8.18
		Max	60.38	37.88	18.3	15.69	22.22	20.24	29.48	13.51	23.17
		Correlation w/ Previous Year	NA	0.38*	0.46*	0.3*	0.50*	0.10	0.22	0.19	0.10
Firm gives comments on government regulation (%)*	PCI Survey Question: F3	Min					15.04	11.36	5.00	2.63	
		Median					25.21	22.37	15.49	13.45	
		Max					43.9	38.35	34.84	31.08	DROPPED
		Correlation w/ Previous Year					NA	0.55*	0.37*	0.36*	
Business Associations's role in advising and countering provincial polices (% Important or Very Important)**	PCI Survey Question: F4	Min					18.64	15.15	9.52	15.33	16.16
		Median					35.71	37.04	31.25	31.81	30.11
		Max					57.32	55.56	60.60	66.25	55.75
		Correlation w/ Previous Year					NA	0.32*	0.03	0.11	0.24

Openness and quality of provincial webpage	Analysis by PCI Research Team (For Scorecard See Section)ψ	Min	0	0	0	0	0	0.00	9.00	0.00	11.50
		Median	10	9	13.75	14.25	15	15.00	15.00	14.00	25.50
		Max	21	18	20	20	20	19.00	20.00	20.00	38.00
		Correlation w/ Previous Year	NA	0.36*	0.51*	0.70*	0.74*	0.79*	0.69*	0.50*	0.5732*
Percentage of firms have accessed provincial websites (%) NEW INDICATOR	PCI Survey 2013 Question: F5	Min									21.43
		Median									50.99
		Max									70.00
		Correlation w/ Previous Year									N.A
Budget documents have enough details for use in business activities (% YES) NEW INDICATOR	PCI Survey 2013 Question: F2.2	Min									35.71
		Median									76.92
		Max									100
		Correlation w/ Previous Year									N.A
Budget documents are published right after being approved (% YES) NEW INDICATOR	PCI Survey 2013 Question: F2.2	Min									27.27
		Median									66.67
		Max									100
		Correlation w/ Previous Year									N.A

* Significant at 5% level; NA = not applicable
All values are at the provincial level.
2005 data only include 42 provinces.
† Indicators result from factor analysis of 13 documents. In 2009, the scale was simplified to reflect the average access on a 5 pt. scale (1 very difficult to 5 very easy)
ψ In 2007 and 2008, 0.5 values were allowed to denote provinces that provided the relevant information, but not in a sufficient manner to be useful.

** Only Business Association members respond

TABLE A4 Comparison of Time Costs of Regulatory Compliance (2005-2013)

Indicator	Source (2013 Survey)	Measure	2005	2006	2007	2008	2009	2010	2011	2012	2013
Percentage of firms spending over 10 percent of their time on understanding and complying with regulations	PCI Survey Question: D6	Min	3.64	6.52	10.94	13.83	7.27	8.13	2.74	3.22	7.88
		Median	13.67	21.24	21.87	22.99	15.38	19	11.26	13.84	20.95
		Max	30.43	39.39	43.75	42.55	30.36	35.37	31.57	28.57	44.44
		Correlation w/ Previous Year	NA	0.44*	0.62*	0.67*	0.44*	0.24	0.25*	0.45*	0.13
Median number of inspections (all agencies)	PCI Survey Question: D1	Min	1	0	1	1	1	1	1	0	1
		Median	1	1	1	1	1	1	1	1	1
		Max	3	2	2	2	2	2	2	2	2
		Correlation w/ Previous Year	NA	0.35*	0.30*	0.46*	0.34*	0.51*	0.14	0.26*	0.32*
Median tax inspection hours	PCI Survey Question: D4	Min	1	1	2	1	1	1	1	1	2
		Median	7.5	8	8	8	5	4	4	4	8
		Max	24	40	40	32	40	28	24	24	40
		Correlation w/ Previous Year	NA	0.62*	0.86*	0.88*	0.75*	0.33*	0.30*	0.21	0.53*
Government officials are effective (% Strongly agree or Agree) NEW INDICATOR	PCI Survey Question: D8.1	Min									58.85
		Median									75.44
		Max									91.76
		Correlation w/ Previous Year									N.A
Government officials are friendly (% Strongly agree or Agree) NEW INDICATOR	PCI Survey Question: D8.2	Min									40.16
		Median									70.00
		Max									86.67
		Correlation w/ Previous Year									N.A
Firms don't have to travel many trips to obtain stamps and signatures (% Strongly agree or Agree) NEW INDICATOR	PCI Survey Question: D8.3	Min									51.58
		Median									70.13
		Max									86.14
		Correlation w/ Previous Year									N.A
Paperwork is simple (% Strongly agree or Agree) NEW INDICATOR	PCI Survey Question: D8.4	Min									44.79
		Median									62.50
		Max									84.00
		Correlation w/ Previous Year									N.A
Fees are listed publically (% Strongly agree or Agree) NEW INDICATOR	PCI Survey Question: D8.5	Min									80.00
		Median									90.51
		Max									98.67
		Correlation w/ Previous Year									N.A
No noticeable improvements are made (% Strongly agree or Agree) NEW INDICATOR	PCI Survey Question: D8.7	Min									43.28
		Median									74.24
		Max									90.74
		Correlation w/ Previous Year									N.A

* Significant at 5% level; NA = not applicable
All values are at the provincial level.
2005 data only include 42 provinces.

TABLE A5 Comparison of Informal Charges (2005-2013)

Indicator	Source (2013 Survey)	Measure	2005	2006	2007	2008	2009	2010	2011	2012	2013
Enterprises in my line of business usually have to pay for informal charges (% agree or totally agree)	PCI Survey Question: D9	Min	6.67	53.57	40	45.54	35.38	20.78	25	28.57	27.54
		Median	26.57	70	68.25	65.93	59.4	58.23	51.39	53.17	50.43
		Max	48.28	84.62	82.72	83.59	77.47	77.11	75.68	74.19	72.38
		Correlation w/ Previous Year	NA	0.05	0.56*	0.64*	0.66*	0.73*	0.61*	0.33*	0.42*
Percentage of firms paying over 10 percent of their revenue for informal charges	PCI Survey Question: D10	Min	0	4.35	1.39	2.13	2.61	0	0	0	0.72
		Median	9.6	12.99	11.54	9.89	8.75	6.78	6.56	6.45	6.96
		Max	29.41	34.38	26.19	22.08	20.78	16.92	18.42	22.73	26.56
		Correlation w/ Previous Year	NA	0.21	0.45*	0.55*	0.60*	0.43*	0.15*	0.23	0.67*
Rent-seeking phenomenon is popular in handling administrative procedures for businesses (% strongly agree or agree)	PCI Survey Question: D14.2	Min		22.86	17.44	20	23.93	22	18.06	18	20.27
		Median		39.76	38.21	37.12	50.35	50	40.28	43.75	41.18
		Max		76.74	79.41	64.54	71.64	73.11	73.13	68.85	75.32
		Correlation w/ Previous Year		NA	0.78*	0.68*	0.66*	0.63*	0.50*	0.51*	0.43*
Percentage of firms saying that informal charges usually or always deliver expected results	PCI Survey Question: D11	Min		20.83	29.03	27.94	35.42	36.4	36.9	24.75	36.84
		Median		47.89	48.28	48.99	51.51	56.32	61.11	60.71	63.16
		Max		65.93	59.8	62.91	69.01	71.64	82.35	76.81	87.23
		Correlation w/ Previous Year		NA	0.2	0.50*	0.50*	0.53*	0.34*	-0.0832	0.18
Informal charges are at acceptable levels (% Strongly agree or Agree) NEW INDICATOR	PCI Survey Question: D8.6	Min									66.67
		Median									80.19
		Max									97.92
		Correlation w/ Previous Year									N.A

* Significant at 5% level; NA = not applicable
All values are at the provincial level.
2005 data only include 42 provinces and do not include the full set of indicators used in subsequent years.

TABLE A6 BIAS -NEW SUB-INDEX

Indicator	Source (2013 Survey)	Measure	2013
Province give privileges to state-owned economic group, corporations, causing difficulties to your business (% Agree)	PCI Survey Question: H4	Min Median Max Correlation w/Previous Year	18.26 32.14 42.86 N.A
Land access as a privilege to state-owned economic group (% Agree)	PCI Survey Question: H4.1.1	Min Median Max Correlation w/Previous Year	13.04 27.59 51.11 N.A
Credit access as a privilege to state-owned economic group (% Agree)	PCI Survey Question: H4.1.2	Min Median Max Correlation w/Previous Year	13.04 27.59 47.92 N.A
Mineral exploitation license as a privilege to state-owned economic group (% agree)	PCI Survey Question: H4.1.3	Min Median Max Correlation w/Previous Year	5.88 19.51 35.42 N.A
Faster and simpler administrative procedures as a privilege to state-owned economic group (% agree)	PCI Survey Question: H4.1.4	Min Median Max Correlation w/Previous Year	5.80 25.86 45.21 N.A
Ease in getting state contracts as privilege to state-owned economic group (% agree)	PCI Survey Question: H.4.1.5	Min Median Max Correlation w/Previous Year	13.04 35.00 56.25 N.A
Province give priority in solving problems and difficulties to foreign companies over domestic one (% agree)	PCI Survey Question: H2.7	Min Median Max Correlation w/Previous Year	11.54 28.30 49.25 N.A
Province give priority to FDI attraction than private sector development (% agree)	PCI Survey Question: H3	Min Median Max Correlation w/Previous Year	17.81 29.50 46.30 N.A
Advantage in land access for FIEs (% agree)	PCI Survey Question: H3.1.1	Min Median Max Correlation w/Previous Year	4.71 12.64 26.67 N.A
CIT reduction and holiday for FIEs (% agree)	PCI Survey Question: H3.1.2	Min Median Max Correlation w/Previous Year	2.86 9.64 24.81 N.A
Advantage in procedures (faster, simplifier) for FIEs (% agree)	PCI Survey Question: H3.1.3	Min Median Max Correlation w/Previous Year	3.66 10.85 22.07 N.A
More government support during FIEs operation (% agree)	PCI Survey Question: H3.1.4	Min Median Max Correlation w/Previous Year	6.17 13.48 26.90 N.A
"Contracts, land, …, and other economic resources mostly fall in the hands of enterprises that have strong connections to local authorities" (% agree)	PCI Survey Question: H5	Min Median Max Correlation w/Previous Year	75.00 96.59 100.00 N.A
Preferential treatment to big companies (both state-owned and nonstate) is an obstacle to their business operations (% agree)	PCI Survey Question: H.2.5	Min Median Max Correlation w/Previous Year	17.57 34.62 60.92 N.A

TABLE A7 Comparison of Proactivity (2005-2013)

Indicator	Source (2013 Survey)	Measure	2010	2011	2012	2013
Firms' assessment of the attitude of provincial government toward private sector (% Positive or Fairly Positive)	PCI Survey Question: H1	Min	31.11	26.25	27.56	26.21
		Median	47	45.33	44.44	43.88
		Max	67.09	82.89	66.94	69.06
		Correlation w/Previous Year	0.56*	0.37*	0.42*	0.49*
The PPC is flexible within the legal framework to create favorable business environment for nonstate firms (% Strongly Agree or Agree)	PCI Survey Question: H2.2	Min	54.37	41.67	34.48	39.66
		Median	75.31	65.15	65.57	62.77
		Max	90.14	92.15	88.31	90.81
		Correlation w/Previous Year	0.68*	0.48*	0.44*	0.05
The PPC is very proactive and innovative in solving new problems (% Strongly Agree or Agree).	PCI Survey Question: H2.3	Min	25	19.35	22.48	33.04
		Median	49.38	46.6	47.66	52.24
		Max	71.11	78.26	71.13	82.76
		Correlation w/Previous Year	0.61*	0.47*	36*	0.24**
There are good initiatives at the provincial level but they are not well implemented by departments (% Strongly Agree or Agree).	PCI Survey Question: H2.1	Min				32.71
		Median				56.98
		Max				87.74
		Correlation w/Previous Year				N.A
Provincial leaders have good policies they are not well implemented at district level (% Strongly Agree or Agree).	PCI Survey Question: H2.5	Min				24.30
		Median				43.40
		Max				76.47
		Correlation w/Previous Year				N.A
Province's reaction to lack of clarity in central policies/documents: % "delay and seek instructions" and "do nothing".	PCI Survey Question: H1.1	Min				11.29
		Median				33.33
		Max				58.16
		Correlation w/Previous Year				N.A

* Significant at 5% level; NA = not applicable
** Significant at 10% level
All values are at the provincial level.
2005 data only include 42 provinces.

TABLE A8 Comparison of Business Support Services (2005-2013)

Indicator	Source (2013 Survey)	Measure	2013
Number of trade fairs held by province in previous year and registered for present year.**	Data provided by Viet Trade of the Ministry of Trade	Min Median Max Correlation w/Previous Year	1 10 44 0.55*
Ratio of the total number of service providers to the total number of firms (%)	"Tax Authority (Author's Calculation)"	Min Median Max	0 0.66 4.6 0.97*
Ratio of the number of nonstate and FDI service providers to the total number of service providers (%)	"Tax Authority (Author's Calculation)"	Min Median Max Correlation w/Previous Year	0 66.67 100 0.95*
Firm has used business information search services (%)	PCI Survey Question: E.6.1	Min Median Max Correlation w/Previous Year	14.75% 32.76% 54.31% 0.06
Firm used private provider for above business information search services (%)	PCI Survey Question: E.6.1	Min Median Max Correlation w/Previous Year	19.23% 42.86% 71.43% 0.16
Firm intends to use above service provider again for business information search services (%)	PCI Survey Question: E.6.1.1	Min Median Max Correlation w/Previous Year	25.00% 61.54% 86.96% 0.25*
Firm has used consulting on regulatory information (%)	PCI Survey Question: E.6.2	Min Median Max Correlation w/Previous Year	12.50% 38.36% 61.11% -0.06
Firm used private provider for consulting on regulatory information (%)	PCI Survey Question: E.6.2	Min Median Max Correlation w/Previous Year	3.85% 28.57% 62.07% 0.42*
Firm intends to use above service provider again for consulting on regulatory information (%)	PCI Survey Question: E.6.1.2	Min Median Max Correlation w/Previous Year	24.14% 56.00% 90.63% 0.29*
Firm has used business match making services(%)	PCI Survey Question: E.6.4	Min Median Max Correlation w/Previous Year	12.28% 30.91% 48.21% 0.16
Firm used private provider for business match making services (%)	PCI Survey Question: E.6.4	Min Median Max Correlation w/Previous Year	21.74% 51.43% 79.63% 0.15
Firm intends to use above service provider again for business match making services (%)	PCI Survey Question: E.6.1.4	Min Median Max Correlation w/Previous Year	23.33% 53.33% 81.08% 0.22

Firm has used trade promotion services (%)	PCI Survey Question: E.6.5	Min Median Max Correlation w/Previous Year	10.30% 27.27% 51.43% 0.21
Firm used private provider for trade promotion services (%)	PCI Survey Question: E.6.5	Min Median Max Correlation w/Previous Year	0.00% 23.81% 72.73% 0.33*
Firm intends to use above service provider again for trade promotion services (%)	PCI Survey Question: E.6.1.5	Min Median Max Correlation w/Previous Year	9.52% 39.13% 66.67% 0.25*
Firm has used technology related services (%)	PCI Survey Question: E.6.6	Min Median Max Correlation w/Previous Year	8.05% 29.51% 52.21% 0.20
Firm used private provider for technology related services (%)	PCI Survey Question: E.6.6	Min Median Max Correlation w/Previous Year	23.53% 46.67% 85.11% 0.24
Firm intends to use above service provider again for technology related services (%)	PCI Survey Question: E.6.1.6	Min Median Max Correlation w/Previous Year	16.13% 37.29% 66.67% 0.23
Firm has used accounting and financing training services (%) NEW INDICATOR	PCI Survey Question: E.6.7	Min Median Max Correlation w/Previous Year	18.24% 35.94% 65.26% N.A
Firm used private provider for above accounting and financing training services (%) NEW INDICATOR	PCI Survey Question: E.6.7	Min Median Max Correlation w/Previous Year	4.76% 31.82% 78.26% N.A
Firm intends to use above service provider again for accounting and financing training services (%) NEW INDICATOR	PCI Survey Question: E.6.1.7	Min Median Max Correlation w/Previous Year	12.50% 41.94% 72.73% N.A
Firm has used business administration training services (%) NEW INDICATOR	PCI Survey Question: E.6.8	Min Median Max Correlation w/Previous Year	10.84% 29.19% 57.89% N.A
Firm used private provider for above abusiness administration training services (%) NEW INDICATOR	PCI Survey Question: E.6.8	Min Median Max Correlation w/Previous Year	0.00% 36.36% 73.27% N.A
Firm intends to use above service provider again for business administration training services (%) NEW INDICATOR	PCI Survey Question: E.6.1.8	Min Median Max Correlation w/Previous Year	7.14% 38.89% 67.57% N.A

* Significant at 5% level; NA = not applicable
All values are at the provincial level.
2005 data only include 42 provinces and do not include the full set of indicators used in subsequent years.
**Because the maximum value recorded in HCMC is an outlier on both of these variables (over two standard deviations greater than the mean value), lower values of 10 and 100, the number scored by the second highest province, were used to standardize the sub-index scores.

TABLE A9 Comparison of Labor Policies (2006-2013)

Indicator	Source (2013 Survey)	Measure	2010	2011	2012	2013
1. Services provided by provincial agencies: general education (% Very Good or Good)	PCI Survey Question: E1.7	Min Median Max Correlation w/Previous Year	20.27% 46.99% 68.97% 0.72*	28.77% 52.05% 75.80% 0.54*	24.6% 54.7% 80.0% 0.35*	31.3% 54.8% 75.3% 0.46*
2.Services provided by provincial agencies: vocational training (% Very Good or Good)	PCI Survey Question: E1.8	Min Median Max Correlation w/Previous Year	10.67% 27.40% 64.37% 0.57*	16.46% 34.88% 68.25% 0.39*	15.25% 42.15% 73.39% 0.26*	17.33% 43.10% 67.78% 0.37*
3. Firm has used labor exchange services (%)	PCI Survey Question: E2.6.3	Min Median Max Correlation w/Previous Year	4.39% 31.11% 48.08% 0.37*	23.76% 52.56% 83.17% 0.31*	13.58% 33.33% 54% 0.14	9.52% 30.10% 48% 0.09
4. Firm used private provider for above labor exchange services (%)	PCI Survey Question: E2.6.1.3	Min Median Max Correlation w/Previous Year	0.00% 39.06% 84.42% 0.39*	3.45% 22.72% 61.80% 0.13*	2.00% 15.62% 39% 0.09	5.88% 45.00% 80% 0.25
5.Firm intends to use above service provider again for labor exchange services (%)	PCI Survey Question: E2.6.1.3	Min Median Max Correlation w/Previous Year	32.65% 62.50% 93.94% 0.02	6.90% 27.78% 53.70% 0.23*	4.76% 19.56% 34.54% 0.1479	5.56% 40.00% 75.00% 0.29*
6.Percentage of total business costs spent on labor training.	PCI Survey Question: E8 (Data is the residual after regresssing labor costs on firm type, sector, size, number of enterprises in province, average industrial wage in province.)	Min Median Max Correlation w/Previous Year	0 (-3.37) 1.25 (-2.44) 3 (0.917) 0.37*	0(-3.31) 1(-2.14) 5(1.02) -0.08	0.87(-2.42) 3.9(-0.039) 7.47(4.03) 0.01	1.2(-1.54) 2.9(-.20) 5.2(2.68) 0.31*
7. Percentage of total business costs spent on labor recruitment	PCI Survey Question: E9 (Data is the residual after regresssing labor costs on firm type, sector, size, number of enterprises in province, average industrial wage in province.)	Min Median Max Correlation w/Previous Year	0 (-3.99) 1 (-2.8) 3 (1.99) 0.21	0(-2.92) 0(-2.30) 1(-0.94) 0.11	1.48(-2.29) 3.82(-0.18) 9.39(4.866) -0.22	0.47(-2.41) 2.09(-0.23) 6.19(4.48) 0.25*
8. Overall Satisfaction with Labor (% Agreeing labor meets firm needs).	PCI Survey Question: E.9	Min Median Max Correlation w/Previous Year	58.40% 73.47% 90.11% 0.28*	42.99% 75.60% 93.75% 0.21*	71.6% 92.7% 100.0% -0.10	85.0% 95.1% 99.0% 0.24
9. Ratio of vocational training school graduates to untrained laborers	Ministry of Labor, Invalids and Socal Affairs: General Labor Department	Min Median Max Correlation w/Previous Year	0.89% 3.13% 20.51% 0.58*	1.03% 3.60% 20.08% 0.93*	0.95% 3.72% 22.42% 0.93*	1.20% 4.60% 22.37% 0.91*
10. Secondary school graduates as % of workforce	General Statistical Office	Min Median Max Correlation w/Previous Year	4.36% 8.65% 28.02% 0.91*	2.73% 7.10% 16.17% 0.65*	2.05% 7.69% 19.09% 0.85*	2.98% 7.59% 19.53% 0.92*
11. Percentage of workers having completed training at vocational schools NEW INDICATOR	PCI Survey Question: E12	Min Median Max Correlation w/Previous Year				23.18% 42.80% 67.25% N.A

* Significant at 5% level; NA = not applicable
All values are at the provincial level. Parenthes in indicators E8& E9 indicate residuals.

TABLE A10 Comparison of Legal Institutions (2006-2013)

Indicator	Source (2013 Survey)	Measure	2006	2007	2008	2009	2010	2011	2012	2013
1. Legal system provided mechanism for firms to appeal against officials' corrupt behavior (% Always or Usually)	PCI Survey Question: G2	Min	7.44%	17.70%	17.22%	13.04%	14.16%	0.00%	9.0%	16.1%
		Median	19.16%	28.80%	27.31%	25.17%	25.00%	23.70%	23.7%	32.6%
		Max	35.53%	41.41%	42.53%	43.94%	53.33%	55.80%	51.7%	69.9%
		Correlation w/ Previous Year	NA	-0.24	0.48*	0.38*	0.27*	-0.08*	-0.12	0.25*
2. Firm confident that legal system will uphold property rights and contracts (% Strongly Agree or Agree)	PCI Survey Question: G1	Min	50.00%	53.57%	55.05%	45.63%	43.36%	0.00%	41.7%	58.2%
		Median	69.42%	66.11%	67.00%	62.32%	62.69%	69.94%	63.8%	83.2%
		Max	82.14%	77.55%	78.23%	75.76%	71.11%	88.76%	81.8%	92.6%
		Correlation w/ Previous Year	NA	0.50*	0.40*	0.29*	0.16	-0.14*	-0.04	0.22
Business used courts or other legal institutions to resolve disputes (%)	PCI Survey Question: G4	Min				4.76%	0.00%	0.00%	0.00%	
		Median				23.33%	25.00%	22.22%	22.22%	DROPPED
		Max				44.83%	90.91%	66.67%	50.00%	
		Correlation w/ Previous Year				NA	0.27*	0.34*	0.17	
3. Cases filed by by non-state entities at Provincial Economic Court per 100 firms.	People's Supreme Court	Min	0	0	0	0	0.00	0.00	0.00	0.00
		Median	0.41	0.58	1.29	3.05	1.74	2.11	1.32	2.09
		Max	9.49	8.12	6.97	35.64	62.10	14.82	9.01	21.74
		Correlation w/ Previous Year		0.66*	0.32*	0.84*	0.84*	0.70*	0.68*	0.57*
4. Non-state claimants as a percentage of claimants at Provincial Economic Court.	People's Supreme Court	Min	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
		Median	50.00	50.00	65.48	72.41	73.47	84.81	90.00	85.71
		Max	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00
		Correlation w/ Previous Year	NA	0.38*	0.05	0.41*	0.40*	0.27*	0.46*	0.30*
Median months to resolve court cases	PCI Survey Question: G3.2	Min				1.00	0.5	1	1	
		Median				6.00	6.00	8.77	3.00	
		Max				19.71	12.63	10.00	30.00	DROPPED
		Correlation w/ Previous Year				NA	0.21	0.23	0.28	
"Median formal and informal costs as a percentage of case "	PCI Survey Question: G3.3	Min				3.09	2.5	1	0	
		Median				12.21	11.73	14.79	10.00	
		Max				60.00	44.5	32.74	100	DROPPED
		Correlation w/ Previous Year				NA	0.03	0.02	0.23	

5. Provincial court judge economic cases by the law (% Agree or strongly agree) NEW INDICATOR	PCI Survey Question: G3.1	Min								78.13%
		Median								89.29%
		Max								98.84%
		Correlation w/ Previous Year								N.A
6.Provincial court resolve economic cases quickly (% Agree or strongly agree) NEW INDICATOR	PCI Survey Question: G3.2	Min								29.47%
		Median								58.00%
		Max								80.65%
		Correlation w/ Previous Year								N.A
7. Court judgements are enforced quickly (% Agree or strongly agree) NEW INDICATOR	PCI Survey Question: G3.3	Min								38.64%
		Median								60.00%
		Max								86.02%
		Correlation w/ Previous Year								N.A
8. Legal aid agencies support business to use laws to sue when disputes arise (% Agree) NEW INDICATOR	PCI Survey Question: G3.4	Min								40.00%
		Median								68.75%
		Max								86.67%
		Correlation w/ Previous Year								N.A
9.Formal and informal costs are acceptable (% Agree or strongly agree) NEW INDICATOR	PCI Survey Question: G3.5	Min								57.35%
		Median								77.78%
		Max								93.26%
		Correlation w/ Previous Year								N.A
"10.Judgement by the court is fair (% Agree or strongly agree) NEW INDICATOR "	PCI Survey Question: G3.6	Min								71.67%
		Median								85.96%
		Max								96.70%
		Correlation w/ Previous Year								N.A
11.Willingness to use court in case a dispute arises (% Yes) NEW INDICATOR	PCI Survey Question: G4	Min								29.31%
		Median								59.74%
		Max								77.87%
		Correlation w/ Previous Year								N.A

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