



Country Update

The WTO Trade Facilitation Agreement: Main Issues Faced by SMEs in S&SE Asian Countries and Their Solution

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All over the world, small and medium-sized enterprises (SMEs) are playing an increasingly central role in the economic development process of nations. In most economies - including Vietnam - smaller enterprises are much greater in number than large firms, they generate new employment opportunities and make significant contribution to the national/global economy. SMEs are also the key players that drive innovation and competition in the market.

However, the sector suffers from several constraints. In today's world of increasing globalization, liberalization and integration, SMEs in developing countries, in addition to traditional problems such as lack of/access to finance, unfavorable business environment, limited production capacity and information asymmetries, are also faced with greater competition due to market opening and removal of protective covers by their home governments, critically lagging behind due to outdated technology and production process, and the absence of mode delivery and

marketing techniques, etc. The recent global financial crisis, negatively affecting demands in all markets, is also making it all the more difficult for SMEs to survive and prosper.

As a member of the World Trade Organisation (WTO) since 2007 and with the various preferential trade agreements (PTAs) and free trade agreements (FTAs) concluded with a multitude of countries all over the globe, and the latest achievements of negotiating the Trans-Pacific Partnership (TPP) agreement and signing an FTA with the European Union (EU-VN FTA) in 2015, this short paper looks at how Vietnamese SMEs have been participating in the country's integration into the world. It examines the main challenges faced by Vietnamese SMEs along this process and what could be done to ensure their success, making use of the various technical assistance and capacity building opportunities available under the WTO Trade Facilitation Agreement, which Vietnam ratified in December 2015.

SMEs in Vietnam

Many studies have observed that private sector development and enterprise reform play a crucial role in the reform of the Vietnamese economy¹ since Vietnam began its transition to a market-led economy in the mid 1980s. As Vietnam has joined the WTO, signed the TPP and other PTAs and FTAs with trading partners the world over, both opportunities and competition grows. In an ever more integrated global economy, a dynamic non-State sector with an emphasis on SMEs in Vietnam is crucial for the overall objective of:

- *Creating employment and income growth by expanding non-farm employment and income opportunities*
- *Attaining sustainable economic development*
- *Improving resource allocation efficiency and productivity growth*
- *Expanding exports and efficiently using imports*
- *Attracting FDI*
- *Achieving a more equal distribution of income; and*
- *Assisting in rural and regional development*².

The 2014 White Paper on SMEs published by the Ministry of Planning and Investment (MPI) of Vietnam³ indicates that, of the total 324,691 enterprises in operation in Vietnam by

01/01/2012, the majority (97.6%) were micro, small and medium in scale, and of those, about 67.6% were micro. The large and medium-sized enterprises accounted for a modest proportion: 2.4% and 2% respectively. SMEs employ around 77% of the workforce and account for 80% of the wholesale and retail trade market. Over 40% of GDP of Vietnam is produced by SMEs.

The reform process also meant that SMEs play an increasingly significant role in the national economy of Vietnam. They are now even considered as the main driving force behind the country's economic development and high growth rate. In 2008, the contribution of SMEs to the growth rate was 11.88%, twice the average national growth rate of 6.18%⁴. In addition, SMEs made a great contribution to production processes, goods circulation, and provision of services linking, supporting and promoting the development of large enterprises.

In 2012, SMEs contributed about 34% of Vietnam's State budget and employed more than 5 million workers, helping to reduce social pressure and the unemployment problem. The total earnings of these enterprises reached about VND 489 trillion in 2011, a two-fold increase as compared to 2008, the average earnings per enterprise also increased from VND 2.1 billion in 2008 to 2.8 billion in 2011.

Most SMEs are found in the trade and services sectors, which account for more than 60% of

¹ See, for example, Harvie, C. (2004), "The Contribution of SMEs in the Economic Transition of Vietnam"

Journal of International Business and Entrepreneurship Development, 2(2): 1-16; or Hakkala, K. and A. Kokko (2007), *The State and the Private Sector in Vietnam*, Working Paper 236, Stockholm School of Economics.

² Harvie, C. (2007), "SME Development Strategy in Vietnam" - Paper presented at the 4th *SMEs in a Global*

Economy Conference: Responding to Global Challenges and

Opportunities, Shah Alam Selangor, Malaysia.

³ Downloadable from <http://en.business.gov.vn/tabid/179/catid/572/item/13807/white-paper-on-vietnam-sme-2014.aspx>

⁴ According to Tran Tien Cuong, Bui Van Dung, Nguyen Thanh Tam & Trinh Duc Chieu (2009), *Integrating Small & Medium Enterprises into the more Integrated East Asia Region: the Case of Vietnam*, in Vo Tri Thanh, Dinonisius Narjoko & Sothea Oum (edited), *Integrating Small & Medium Enterprises (SMEs) into the more Integrated East Asia*, ERIA Research Project Report 2009, No, 8.

the total number of SMEs in Vietnam. This is followed by the manufacturing sector, containing around 17-18% of SMEs. The figures in these categories, however, show a declining trend, with a notable increase in the number of SMEs participating in agriculture & forestry and construction, though not significant. The overall sectoral structure is more or less in line with the new trends of worldwide economic development, which see an ever-increasing role of the services sector in GDP contribution of most countries.

A large percentage of the SMEs in Vietnam still constitute household establishments (66.5%), which are not formally registered under the law, according to the Vietnam SMEs Survey in 2009. More modern forms of business, such as limited liability and shareholding companies also stand out, but not significantly. Notably, micro enterprises tend to remain informal more than SMEs of relatively larger sizes (small and medium). The 2009 SME Survey also shows that more SMEs in Vietnam have become exporters over time (6% of the sample size) and that larger enterprises have a higher probability of exporting. According to the survey results, the share of exporting enterprises among new entrants was lower than among incumbent enterprises. Urban enterprises are more likely to export directly than rural enterprises. Ownership type also plays a significant role. Household enterprises are unlikely to export, while 18 and 17 percent of the limited liability and shareholding companies export, respectively.

The Vietnam Provincial Competitiveness Index 2015 (PCI),⁵ an annual report administered by the Vietnam Chamber of Commerce and Industry (VCCI) since 2005, which uses an annual business survey to assess and rank the economic governance quality of provincial

authorities in creating a favorable business environment for the private sector, indicates that 65% of SMEs surveyed had to pay informal charges to gain access to governmental support, while 75% of SMEs needed relationships to get official documents and information. SMEs' awareness of business incentive policies offered by central and local offices is between 51 and 61%, while only 20 to 30% acknowledged actually using these services. Also according to the report, the majority of Vietnamese SMEs rely only on the domestic market, with only 3% of micro-sized, 4% of small-sized, and 9% of medium-sized firms have customers that are foreign individuals or enterprises.

Challenges & Constraints

Vietnam's accession to the WTO has opened up great opportunities for the country. However, accession also requires considerable structural reforms and the development of institutions and policies to monitor and comply with its accession commitments. In addition, WTO accession creates significant challenges and opportunities to Vietnam's young SME sector despite its increasing role in the overall economy and dynamism.

While the WTO creates a 'rules-based' trading environment and aims to level the playing field worldwide, it does not specifically deal with the issues of SMEs but rather lumps them in with enterprises in general. This poses great challenges to the SME sector in Vietnam, as it did to many other developing countries⁶. Those challenges include issues such as:

- i. Increased international competition as a result

⁵ Downloadable at
<http://eng.pcivietnam.org/tailieu/PCI2015-Report_EN.pdf>

⁶ Based on MUTRAP, *Communicating the package of WTO commitments and implications to different stakeholders*, Hanoi, October 2007

of markets being opened up;

ii. Increased pressure to produce products that are competitive in price, quality, and delivery schedule so that they can be sold in both the domestic and international markets;

iii. Formerly sheltered SMEs may lack the necessary management skills, expertise, and information for competing with their trading counterparts;

iv. Lack of cooperation amongst SMEs – The coordination within industry association is currently not enough to help Vietnamese SMEs to form production networks to increase efficiency and benefit from economies of scale;

v. Non tariff trade barriers (TBTs) in other markets – Barriers such as standards, compliance with labeling and rules of origin, which are all complex matters for enterprises of small and micro scale in a developing economy like Vietnam;

vi. Poor overall macro-economic policy framework and severe lack of soft infrastructure development (such as business management, accounting practices, and administrative education) to support SME's and WTO obligations;

vii. Limited transparent legal framework to provide for protection and equitable remedies of the law;

viii. Language issues & understanding of international business practices;

ix. Poor hard infrastructure issues such as roads, communications, and energy supply;

x. Lack of protection of intellectual property rights versus protection of traditional business practices;

xi. Difficulty in accessing capital from the formal financial sector – According to the MPI, only 32.4% of SMEs are qualified for formal bank

loans, thus requiring them to obtain financing from somewhere else;

xii. The micro-size of many SMEs – creating challenges to re-investment in production.

In the face of these challenges, the plight of Vietnam's SMEs sector under WTO accession seems quite difficult. However, the changes taking place also give strength to Vietnamese SMEs and offer them new opportunities to integrate into the international supply chains. Membership in the WTO, TPP, EU-VN FTA, and other FTAs will bring to Vietnam an improved business environment (or at least the pressure for further adaptation) and other opportunities such as:

- *Greater access for Vietnamese goods and services resulting from opening up of markets;*
- *The establishment of necessary soft and hard infrastructure to meet demands (which also creates jobs and opportunities for suppliers of goods and services);*
- *Transfer of knowledge (including everything from technology to management systems);*
- *Increased standardization (improving quality, creating better credibility and increasing access to larger market opportunities);*
- *Development of the service sector (fastest growing sector worldwide);*
- *The possibility of participating in international production networks and global supply chains through - becoming suppliers to foreign companies and investors both inside and outside of Vietnam.*
- *Partnering with foreign investors both domestically and internationally – licensing as distributors, marketers, suppliers, managers.*

The opportunities are there to seize, but considering the challenges that come along, Vietnamese SMEs would have quite a hard

time when the economy is finally fully opened according to its accession commitments. SMEs will need a lot of support in order to become globally competitive and move up the value chain. The challenge then is to develop mechanisms and vehicles that will assist small and micro businesses to grow into viable, competitive enterprises, and to enable them to make use of the opportunities that may accrue from trade liberalization and integration.

Top 10 improvements needed for Vietnamese SMEs to facilitate trade and integration
<ol style="list-style-type: none"> 1. SMEs' weaknesses relating to financial resources, human resources and technological capabilities are the constraints limiting their ability to meet requirements for <i>product</i> (e.g. in developing new products) and <i>price</i> (e.g. in offering competitive prices as compared to those offered by other businesses); 2. <i>Shortage of working capital</i> to finance new business plans, new projects (i.e. lack of capital and credit access); 3. The difficulty of matching competitors' prices – identifying the necessary <i>information</i> for production and business activities, esp. information about market and potential business partners – this limits the process of offering prices and securing customers; 4. <i>Difficulty in getting credit</i> from supplier and financial institutions in general; 5. The <i>poor and deteriorating economic conditions</i> of the home market, along with inadequacy of basic and ICT infrastructure, making it difficult for expansion and development of enterprises; 6. Insufficient quantity of and/or <i>untrained personnel</i> for market expansion (i.e. human resources, labor difficulty); 7. Low familiarity with the <i>complexity of procedures or paperwork</i> required; 8. <i>Lack of home government assistance</i> or incentives; 9. <i>Lack of production capacity</i> to expand; and 10. The need for <i>promotional activities</i>, to target markets or business partners.
<p>Source: Compiled from Tran Tien Cuong, Bui Van Dung, Nguyen Thanh Tam & Trinh Duc Chieu (2009), <i>Integrating Small & Medium Enterprises into the more Integrated East Asia Region: the Case of Vietnam</i>, in Vo Tri Thanh, Dinonisius Narioko & Sothea Oum (edited), <i>Integrating Small & Medium Enterprises (SMEs) into the more Integrated East Asia</i>, ERIA Research Project Report 2009, No, 8</p>

Logframe Analysis of Constraints Faced by Vietnamese SMEs during Trade Integration

Advantages

External factors:

- Home country's trade liberalization and integration into the region and the world
- Vietnam increasingly being viewed by worldwide businesses as an attractive market, as well as offshore/outsourcing location
- The proliferation of global supply chains and international production networks as the new way of doing business
- Unprecedented development of the services sector and the knowledge economy, allowing developing countries to jump important parts of the development path.

Constraints

External factors:

- Lack of home government support or government supports have been *ad hoc* without strategic vision and long-term policy coherence
- Potential competition from peers in the region
- The global financial crisis continues to negatively affect business
- Underdeveloped logistics industry and infrastructure, especially with regard to Information & Communication Technology (ICT)
- Highly-complex regional and global institutional frameworks (i.e. free trade agreements and investment agreements) and remaining NTBs & TBTs
- Information asymmetries

Some Solutions

A lot of these aforementioned constraints have to be addressed by the SMEs themselves, especially the internal factors. Resolution/personal drive for growth, in our opinion, would play the first key part before Vietnamese SMEs could further embark on the development path vis-à-vis world partners. The role of the enterprise leaders, i.e. entrepreneurship, hence is crucial.

The Government of Vietnam (GOV) has also been providing a lot of support towards the country's SMEs sector. The GOV's Administrative Procedures Simplification Scheme (Scheme 30), for example, which was initiated in 2010, addresses a number of areas related to business, including (i) reform of the tax billing procedures to allow businesses to print invoices by themselves instead of manually registering, declaring and paying taxes; (ii) reform and modernization of the import-export customs procedure by expanding electronic customs declaration, implementing a national single window mechanism connecting various ministries and governmental agencies; etc. However, all these facilitative measures by the GOV need to be continued with further efforts. In the 2013 Doing Business Report – Smarter Regulations for SMEs of the International Finance Corporation (IFC) and the World Bank (WB) in 2013, Vietnam ranked 99th, belonging to the middle group in the overall rankings, with very low ranking in some categories, for example access to electricity (155/185), investor protection (169/185), tax payment (138/185), and handling insolvent business (149/185). Most recently, the Prime Minister of Vietnam issued the Decision No. 1231/QĐ-TTg dated 07/09/2012 approving the 2nd SMEs Development Plan for the 2011-2015

period, with the objective of “setting up 350,000 new businesses and striving to have approximately 600,000 at the date of 31/12/2015. In particular, the export proportion of the SMEs sector should account for 25% of the country's total exports, [...] creating 3.5 to 4 million new jobs over the period of 2011-2015.” This important Decision introduced 8 groups of supporting measures for SMEs development including:

- *Finalising the legal framework for enterprises to enter, operate in and withdraw from the market;*
- *Facilitating access to finance and credit, and improving the efficiency of using capital for SMEs;*
- *Supporting technological innovation and new technology application in SMEs;*
- *Developing human resources for SMEs; focusing on building the capacity of SMEs in corporate governance;*
- *Promoting the formation of industrial clusters; improving access to land for SMEs;*
- *Providing support information to SMEs; and promoting market expansion for SMEs;*
- *Building a system of SMEs Development Agencies; and*
- *Managing the implementation of the Plan.*

Last but not least, Vietnam has ratified the WTO Trade Facilitation Agreement in December 2015, and has so far notified 15 provisions/obligations under Category A. The country is at the moment examining the remaining 25 obligations vis-à-vis its legal and institutional framework, to be able to notify under Category B & Category C, probably one year after the TF Agreement enters into force.⁷

⁷ See, for example, <http://wtocenter.vn/news/vietnam-committed-wto-trade-facilitation-agreement> or [\[location-news/uk-supports-vietnam-in-implementing-wtos-trade-facilitation-agreement\]\(https://www.gov.uk/government/world-location-news/uk-supports-vietnam-in-implementing-wtos-trade-facilitation-agreement\)](https://www.gov.uk/government/world-</p></div><div data-bbox=)

To oversee national implementation of the TF Agreement, each member must establish a national trade facilitation committee that, to be effective, requires the participation of all relevant border agencies. In December 2014, Vietnam Trade Facilitation Alliance was established as a collaboration between U.S. Agency for International Development, the American Chamber of Commerce in Vietnam and the VCCI. This private sector-led alliance is expected to support the TFA implementation, as well as next generation of free trade agreements such as the TPP.⁸ However, the level of awareness amongst Vietnamese business in general and SMEs in particular about the WTO TFA and the likely benefits they might be able to enjoy therefrom remains extremely limited. In the future, the GOV plans to continue disseminating information about the contents of the TFA, while encouraging the business to identify regulations, practices with regards to customs procedures, as well as other problems affecting the effectiveness of the TFAs; then highlight/flag these issues along with recommended solutions/changes to the attention of State agencies responsible for the implementation of the TFA, business/industry associations, and other monitoring agencies.⁹

⁸https://www.wto.org/english/res_e/booksp_e/aid4trade15_chap4_e.pdf

⁹ See, for example,

<[http://wtocenter.vn/sites/wtocenter.vn/files/event-](http://wtocenter.vn/sites/wtocenter.vn/files/event-education/attachments/5.2.%20Presentation%203%20-%20Mr%20Huynh%20-%20TFA%20va%20DN-EN.pdf)

[education/attachments/5.2.%20Presentation%203%20-%20Mr%20Huynh%20-%20TFA%20va%20DN-EN.pdf](http://wtocenter.vn/sites/wtocenter.vn/files/event-education/attachments/5.2.%20Presentation%203%20-%20Mr%20Huynh%20-%20TFA%20va%20DN-EN.pdf)>



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