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VIETNAM'S PRIVATE SECTOR GROWTH

TEACHING NOTE

This case is intended to encourage participants to consider the social cost of weak regulatory environments, poorly designed economic laws, and the relationship between these conditions and the production of (undesirable) commercial norms. In the following notes, I have outlined a few discussion questions and possible scenarios for leading this case study.

What is Mr. Nam's Dilemma?

This question will help participants frame the issue. Mr. Nam encounters several difficulties, accordingly participants will likely articulate the problem in many ways. But, essentially, Mr. Nam has an unprecedented opportunity to expand production, however, to do so, he must obtain external debt or equity finance which will entail an independent audit of his company. Mr. Nam is concerned that an audit will result in the confiscation of his company's assets, and jail time, because he has bribed officials and evaded taxes.

How did Mr. Nam's Dilemma Arise?

Recalling that some businesses paid lower port and customs fees than Mr. Nam, participants may consider how these price differentials effected the competitiveness of Mr. Nam's business and created incentives for him to seek a lower price.

In discussing this question, case study leaders may find it useful to flesh out the following issues:

1. Why did Mr. Nam use a "service company" to bargain with the port officials, why didn't he simply do the bargaining himself?
This question may help participants recognize and explain the price differentials in terms of information costs

2. Under what circumstances do unofficial fees prevent otherwise beneficial exchange?
This question may challenge participants to analyze how regulatory discretion, if abused, can redistribute surplus value from private business to government officials, or other third parties.

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3. What were Mr. Nam's Alternatives?

This question will challenge participants to consider the legal and regulatory barriers to each of Mr. Nam's alternative methods of finance.

Recalling the foreign investor was put off by the complex regulations, participants may consider the "signaling effect" such rules have upon potential investors expectations of government attitudes.

In analyzing why "State Bank C" was only willing to loan Mr. Nam 10 percent of the market value of his Land Use Right, participants may consider how transaction costs can eliminate the financial value of resources.

In considering why the money lender, Mr. Pham, was willing to approve an unsecured loan to Mr. Nam when "State Bank A" and "Private Bank B" were unwilling to approve a secured loans, participants may consider collateral in the form of .reputation.. In discussing this question, it may be useful to consider: (1) Why a loan from Mr. Pham had an interest rate four times over the commercial interest rate?

Finally, the case leader may encourage participants to consider alternatives not mentioned in the case study. For instance, should Mr. Nam consider listing his company on the Ho Chi Minh City Securities Exchange? This likely raises similar auditing issues.

Do Vietnamese Policymakers have an Interest in Mr. Nam's Situation?

Reduced Total Investment? The Enterprise Law does not allow foreign investors to contribute more than 30 percent of the charter capital or participate in the management of a domestic private enterprise. Participants may consider the effect this prohibition has on the growth of Vietnam's domestic enterprises. Participants should articulate public policy rationales and critiques for this rule.

Inconsistent treatment? Participants may contrast the Foreign Investment Law ("FIL"), which requires investors to ask for official permission and licenses to register and invest, with the Enterprise Law, which gives individuals the right to register their business. Participants should consider if the FIL's registration and licensing requirements have an effect on investor costs and total investment.

Agency Problems and Incentives? Participants may consider what affect the Law on Credit Institutions, which permits state owned banks "to make unsecured loans" to SOEs and guarantees that "any losses… from such loans shall be dealt with by the Government," has on a State Bank's incentive to loan funds to a private enterprise. Also, participants may consider whether this provision creates additional personal risks for loan officer approving a loan to a private firm.

Increased risk? Assuming Mr. Nam accepts Mr. Pham's loan, participants should consider what effect, if any, the loan's high interest rate will have on Mr. Nam's insolvency risk. As a corollary, participants should consider what Mr. Nam's other creditors would think of Mr. Pham's loan.

Please Make Policy Recommendations to Address Mr. Nam's Dilemma

If participants are familiar with the Coase Theorem they may want to consider a policy solution in the following way:

1. Assuming no transaction costs, what is the efficient outcome in Mr. Nam's case study?
2. What are the major transaction costs preventing this outcome?
3. What policies, if any, can help reduce these transaction costs?

Finally, in answering question #3 it may be useful for participants to compare these two situations:

In the first situation, a customs official is paid a salary of $100 USD per month, which is not enough to pay for the basic needs of his family. The legal code is complex and seems arbitrary, and local businesses are unable to understand or remain competitive if they are in compliance. The underpaid officials, with the job of administering the rule, accepts a $200 unofficial fee from the business in order to process the necessary documents. With this fee, the official is able to provide for his family, and the business is able to avoid the complexity of the law.

In the second situation, the official is well paid, the law is clear and consistently enforced, and the business' competitiveness will not be sacrificed by complying with the law. However, the business makes a $200 unofficial payment to decrease the costs of compliance, and the official accepts payment because he wants more money.

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