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# EXPLANATORY FACTORS BEHIND FORMALIZING NON-FARM HOUSEHOLD BUSINESSES IN VIETNAM

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## Abstract:

This article sets out to investigate the reasons why some household businesses decide to register and become formal (while others do not) in order to shed light on the origins of informality. We use qualitative as well as quantitative data on household businesses (HB) derived from first-hand representative surveys implemented in Hanoi and Ho Chi Minh city. The study reveals that although most of the informal businesses operate 'illegally', this is more due to unclear registration legislation than the mark of a deliberate intention to evade the economic regulations. Among the different factors which influence the registration decisions, the reason for setting up the business appears to be a determining one: the more it is a real choice (businesses set up to be independent or to follow a family tradition) and the less a constraint (set up for lack of an job alternative), the more the HB is more inclined to be registered. Furthermore, the analysis highlights that incentives do prove decisive insofar as the probability of having a formal business is greater among HB heads who consider that registration provides at least partial protection from corruption. Besides, access to information, the market and large business orders also drive the informal entrepreneurs to register. These results stress the need for clarification of the legal framework as well as incentive policies in order to address the issue of informality.

**Key words:** Informal Sector, Vietnam, Registration, Corruption, Incentives.

## Résumé

Cet article se propose d'analyser les raisons pour lesquelles certaines unités de production (*household businesses*, HB) décident de s'enregistrer et de devenir formelles (et pourquoi d'autres ne le font pas) afin d'éclairer les origines de l'informalité. Nous mobilisons des données aussi bien quantitatives que qualitatives sur les HB, issues d'enquêtes représentatives et de première main conduite par nos soins à Hanoï et Ho Chi Minh ville. L'étude révèle que bien que la plupart des unités informelles opère "illégalement", ce trait procède plus d'une législation floue et méconnue que d'une volonté délibérée d'échapper aux régulations publiques. Parmi les différents facteurs qui jouent sur la décision de s'enregistrer, le motif qui a conduit à s'établir à son compte est déterminant : plus il s'agit d'un véritable choix (volonté d'échapper au salariat ou par tradition familiale) et moins il résulte d'une contrainte (manque d'alternative d'emploi), et plus le chef d'unité sera enclin à s'enregistrer. De plus, l'analyse met en évidence le rôle des incitations dans la probabilité de devenir formel. Ainsi, ceux qui considèrent que l'enregistrement protège (au moins partiellement) de la corruption sont plus nombreux à régulariser leur situation. Enfin, l'accès à l'information, aux marchés et aux commandes des grandes entreprises favorisent l'enregistrement. Ces résultats soulignent le besoin de clarification de la législation des entreprises ainsi que l'importance de politiques incitatives pour s'attaquer à la question de l'informalité.

**Mots Clés :** Secteur informel, Vietnam, enregistrement, corruption, incitations.

**JEL Code:** J24; O17; N85

## 1. Introduction

The informal sector is predominant in Vietnam. In 2007, it accounted for almost 11 million of the country's 46 million jobs. This represented nearly a quarter of all main jobs, with nearly half of non-farm jobs found in the informal sector. All in all, there were 8.4 million informal household businesses (IHBs) out of a total number of 10.3 million household businesses (HBs), of which 7.4 million were held by an HB head in his/her main job and 1 million in his/her second job (Cling *et al.* 2010). Hanoi and Ho Chi Minh City (HCMC), which are the two main economic hubs in Vietnam and the focus of this paper, counted more than 1 million informal household businesses (out of 1.4 million HBs). IHBs employed 1.5 million people (2.2 million people in all HBs) and were the leading source of employment. In keeping with international definitions, the informal sector is defined as all private unincorporated enterprises that produce some of their goods and services for sale or barter, are not registered (no business licence) and are engaged in non-agricultural activities (ILO 2002).

The massive presence of the informal sector is not specific to Vietnam: in less developed countries, informality is the norm rather than the exception (Jütting and de Laiglesia 2009). The economic literature contains three dominant schools of thought on the origins and causes of informality (Roubaud 1994, Bacchetta *et al.* 2009). The 'dualist' approach is an extension of the work by Lewis (1954) and Harris and Todaro (1970). It is based on a dual labour market model where the informal sector is considered to be a residual component of this market totally unrelated to the formal economy. It is a subsistence economy that only exists because the formal economy is incapable of providing enough jobs. Unlike the dualist school, the 'structuralist' approach focuses on the interdependencies between the informal and formal sectors (Moser 1978, Portes *et al.* 1989). Under this neo-Marxist approach, the informal sector is part of, but subordinate to the capitalist system; by providing formal firms with cheap labour and products, the informal sector increases the economy's flexibility and competitiveness. Last of all, the 'legalist' or orthodox' approach considers that the informal sector is made up of micro-entrepreneurs who prefer to operate informally to evade the economic regulations (De Soto 1989); this liberal school of thought is in sharp contrast to the other two in that the choice of informality is voluntary due to the exorbitant legalization costs associated with formal status and registration.

A brief overview of the literature on the informal sector in Vietnam draws a mixed conclusion about the determinants of employment in the informal sector. Many studies take up the orthodox theory that cumbersome public regulations, both *de jure* (2000 and 2005 Law on Enterprises) and *de facto*, obstruct the process of business formalization (Van Arkadie and Mallon 2003, Taussig and Pham 2004, Malesky and Taussig 2009, Nguyen Trang and Pham Minh Tu 2006, Vijverberg *et al.* 2006). This topic draws in particular on work by the World Bank's *Doing Business* programme (2009) and its local offshoots such as the *Provincial Competitiveness Index* (Malesky 2008). A few other studies highlight the segmentation of the labour market, which is consistent with the dual approach (Rand and Torm 2012a). In the same vein, Oostendorp *et al.* (2009) study the household business dynamics and consider that this is a low productivity sector that serves as a safety net for the poor. A fraction of the literature also looks at small and micro-enterprises and craft activities, especially the

phenomenon of craft villages, which is highly specific to this country (Fanchette and Nguyen 2012). These craft villages specialize in one production each (clothing, furniture, pottery, etc.). Together with a few formal enterprises, both formal and informal household businesses operate there, often as sub-contractors.

This review of the literature also points up three observations:

- First of all, few of these studies take up the international definition of the informal sector based on unregistered household businesses. Either they cover a broader spectrum of private sector enterprises and include the informal sector in household businesses (Taussig and Pham 2004, Oostendorp *et al.* 2009) or they adopt measures that confuse the informal sector with informal employment (Tenev *et al.* 2003). Indeed, until recently, the Vietnam Household Living Standards Survey (VHLSS) conducted by the General Statistics Office (GSO) was the only nationally representative statistical survey providing an approximate measure of the informal economy (but no direct measure of the informal sector);
- Secondly, most of these studies are based on ad-hoc partial surveys that only cover a few hundred businesses concentrated in certain activity sectors (for street vendors, see Jensen and Peppard 2003) and certain provinces that differ depending on the study in question. The most ambitious survey of small and medium-sized enterprises in Vietnam is managed by the Central Institute for Economic Management (CIEM) and the University of Copenhagen. It covers over 2,000 businesses. Many studies draw on this survey data (Rand and Torm 2012a, Tran *et al.* 2008), but the survey cannot claim to be representative of the informal sector (and indeed the authors do not claim so);
- Last of all, none of these studies specifically addresses the determinants of registration. Instead, they interview the heads of household businesses about their problems and economic constraints and draw conclusions from their answers concerning their registration behaviour and the determinants of the informal sector. Some other studies measure segmentation by means of estimates of wage gaps and derive from them a diagnostic on the dualism of the labour market (Rand and Torm *ibid*).

This article sets out to analyze the interactions between the State and the informal sector in order to improve our understanding of the origins of informality. It goes further than the abovementioned studies on the subject. It is the first to take into account direct observations of the informal sector based on international definitions in order to analyze the determinants of registration using econometric estimates on individual data. Two representative surveys (*I-2-3 surveys*) conducted by the authors specifically to measure the informal sector in Hanoi and Ho Chi Minh City provide the basis for this paper. We also draw some results from qualitative interviews conducted on a sub-sample of the quantitative surveys (Razafindrakoto and Nguyen 2010).

The remainder of the paper is organized as follows. Section 2 presents the data and the main characteristics of the informal sector in the two main economic hubs in Vietnam, Hanoi and HCMC. Section 3 presents the legislation on household business registration and describes the

extent to which the informal sector is unknown to the State registration services. Section 4 sheds light on informal unit heads' attitudes to registration using descriptive statistics. Section 5 estimates econometric probit models on individual data in order to analyze the determinants of registration. The last section concludes.

## **2. Informal sector data and main characteristics**

The GSO conducted the Labour Force Survey (LFS) for the first time in August 2007 on a large nationwide sample of 173,000 households, with the technical assistance of the authors. In addition to the general objective to produce a broad set of labour market indicators in line with international standards, the questionnaire was also specifically designed to capture the informal sector and informal employment. The LFS measured employment in household businesses (formal and informal) and painted an overall picture of the informal sector in Vietnam, comparing it with other sectors of activity. In Vietnam, household businesses are supposed to have no more than ten employees and to have one establishment only. Above this threshold, or if they have two or more establishments, HBs must become corporate enterprises governed by the Law on Enterprises. The LFS also identified the household businesses' heads, who were interviewed in the second phase (see below).

A specific Household Business & Informal Sector (*HB&IS*) Survey was grafted on to the LFS2007 and carried out by interviewing HB heads identified by the LFS, in keeping with the framework of mixed (household-enterprise) surveys (ILO 2012). It was conducted in Hanoi in December 2007 and in Ho Chi Minh City (HCMC) in January 2008 under a research programme led by the authors of this paper.<sup>1</sup>

This representative business survey in each of the two provinces interviewed 1,305 HBs in Hanoi (992 informal and 313 formal) and 1,333 HBs in Ho Chi Minh City (962 informal and 371 formal). This targeted survey was designed to provide reliable, low-cost estimates of the weight and characteristics of the informal sector, based on the *1-2-3 Survey* methodology (Razafindrakoto *et al.* 2009). It provided very rich and detailed information on the informal sector, which forms the basis of the research presented in this paper.

The questions were mostly quantitative, but some questions, especially those on determinants of registration, were qualitative in view of their different nature. The answers to the *HB&IS* survey on registration were rounded out by a qualitative survey (semi-directive interviews) conducted by the authors with 60 HBs in Hanoi and Ho Chi Minh City. These qualitative questions were designed to provide more insight into the reasons why some household businesses decide to register and become formal (while others do not) and the implications of registration for their business. The answers on this subject are analyzed in Section 4.

If we exclude farming activities, the total number of informal household businesses comes to approximately 300,000 in Hanoi and 750,000 in HCMC. Total employment in these HBs amounts to respectively 470,000 and one million workers. The large gap in the number of informal household businesses and jobs between the two largest cities in Vietnam (the ratio is less than 1 to 2) may be due to two factors. First, HCMC is the larger of the two cities in terms of geographical and residential area as well as population.<sup>2</sup> Second, the private sector in

the southern city is reportedly more developed (as this city is more market-oriented compared with the capital city).

The informal sectors in Hanoi and HCMC share a fairly similar structure by industry (Table 1). In both cases, IHBs are concentrated essentially in ‘*services*’ (respectively 40% and 42% of total employment) and ‘*trade*’ (31% and 29%), and only marginally in ‘*manufacturing & construction*’ (28% and 29%). ‘*Services*’ consist mainly of small restaurants, repair services and transport; ‘*trade*’ of the wholesale and retail trade; and ‘*manufacturing*’ of food and textile & clothing products.

IHBs operate in precarious conditions and have little access to public services. They are atomized and entrepreneurial dynamics seem limited. The informal sector comprises an extremely high number of micro-units. In Hanoi as in HCMC, the average size of an IHB is 1.5 workers including the IHB head. The average size of an FHB is larger, especially in HCMC. The lack of premises is a major constraint that prevents IHBs from increasing their manpower. Only 16% of IHBs in Hanoi and 12% of IHBs in HCMC have specific professional premises from which to run their business. About 50% of informal entrepreneurs work from home and nearly 40% have no premises. The proportion of IHBs operating without premises is the highest in ‘*trade*’ and ‘*services*’, which often work outdoors, and the lowest in ‘*manufacturing*’, where it is totally marginal.

Table 1. Characteristics of informal household businesses in Hanoi and HCMC

	Hanoi							
	IHBs (%)	Jobs (%)	Average size	Type of premises (%)			Mixed Income (Millions VND)	
				No premises	Home	Prof. remises	Average	Median
Manufacturing	18.2	27.8	2.2	6.5	85.4	8.1	2,298	1,500
Trade	37.3	32.6	1.3	45.3	32.5	22.2	2,195	1,330
Services	44.5	39.6	1.3	49.1	36.9	14.0	2,553	1,557
<b>Total IHB</b>	<b>100</b>	<b>100</b>	<b>1.4</b>	<b>39.9</b>	<b>44.1</b>	<b>16.0</b>	<b>2,365</b>	<b>1,500</b>
<b>Total FHB</b>	-	-	<b>2.3</b>	<b>5.8</b>	<b>35.3</b>	<b>58.9</b>	<b>3,597</b>	<b>1,500</b>
	Ho Chi Minh City							
	IHBs (%)	Jobs (%)	Average size	Type of premises (%)			Mixed Income (Millions VND)	
				No premises	Home	Prof. remises	Average income	Median income
Manufacturing	21.9	29.6	2.0	2.0	91.5	6.5	1,919	1,300
Trade	32.2	28.7	1.3	42.5	41.5	16.0	2,055	1,270
Services	45.9	41.7	1.4	50.2	38.1	11.7	2,394	1,473
<b>Total IHB</b>	<b>100</b>	<b>100</b>	<b>1.5</b>	<b>37.2</b>	<b>50.9</b>	<b>11.9</b>	<b>2,156</b>	<b>1,371</b>
<b>Total FHB</b>	-	-	<b>2.6</b>	<b>2.9</b>	<b>36.3</b>	<b>60.8</b>	<b>2,750</b>	<b>1,500</b>

Source: HB&IS Survey, Hanoi (2007), Ho Chi Minh City (2008), GSO-ISS/IRD-DIAL; authors’ calculations.

The corollary of these precarious operating conditions is poor employment, earnings and labour conditions. Despite long working hours, earnings are low and social security coverage is non-existent. The average monthly income amounts to 2.2 million VND in Hanoi and to 2.4

million VND in HCMC (respectively 137 and 150 USD).<sup>3</sup> It is higher by half for FHBs in Hanoi and about one-third higher in HCMC. The median monthly income is 1.5 million VND in Hanoi (less than 100 USD) and slightly less in HCMC, without any significant difference between IHBs and FHBs. The vast majority of the workers are self-employed or family workers. The proportion of wage earners is very low. The number of years of schooling is below the average in Vietnam. Formal agreement between employers and employees in the form of a written contract exists only in exceptional cases. Workers in formal household businesses benefit from better conditions than in informal ones, even though these are far from satisfactory. Women are overrepresented in the informal sector, especially in HCMC (where women represent 56% of employment compared with only 42% in the formal sector).

### **3. Legal framework and current registration situation**

In Vietnam, not all household businesses have to register. Two kinds of households are exempt: those earning less than a certain amount set at district level (which cannot be below the minimum wage), and street vendors and *xe ôm* (motorbike taxis).

Below a certain level of business done, household businesses are not required to get a business licence and can operate freely. Household businesses are exempt from business tax (and now from personal income tax) if their turnover is too small. The empirical evidence suggests that the informal sector as a whole is unknown to the State registration services. Nevertheless, the absence of registration (*business licence*) does not mean that the informal sector is not taxed; more than one-third of IHBs pay one sort of tax in Hanoi (mostly local taxes), although this proportion is much lower in HCMC.

The Ministry of Planning and Investment (MPI) is in charge of fixing the rules for registration of household businesses. Provincial MPI directorates are in charge of registration, which is conducted in practice by the districts. The problem is that the conditions are vague: there are numerous criteria, exceptions and different thresholds. Almost no IHBs (less than 1%) know the threshold above which HBs have to register. Even among the formal HBs, only a minority claim that they know the registration legislation (10% of FHBs in Hanoi and 20% in HCMC), and their knowledge appears to be limited since the magnitude of the registration threshold that they put forward varies substantially (from 2 million to 15 million per month).

We can compute the proportion of IHBs that should be registered by law and, conversely, the proportion of FHBs that need not. These calculations should be viewed with caution, as the law itself is not very clear about which HBs should legally have a business licence and we do not know exactly what the actual locally adopted threshold is above which HBs have to register. Excluding the sectors exempt from registration, the proportion of IHB heads earning more than the minimum wage then provides an indicator of the percentage of ‘illegal’ IHBs (upper bound estimator). In fact, one can consider that almost all household businesses (HBs) should theoretically be registered: as the thresholds are very low, there are almost no household businesses below them that are therefore exempted from registration, with haziness subsisting as to the legal need for roving HBs to register (Cling *et al.* 2010).

Our calculations have been undertaken using the *HB&IS* surveys conducted in Hanoi and Ho Chi Minh City. The selected income variable is the operating surplus taken from the *HB&IS* Surveys (we prefer not to use earnings as the declarations are notoriously underestimated). We consider three legislative hypotheses: a) all HBs should have a business licence when they earn more than the minimum wage (450,000 VND/month; b) this income criterion does not apply to mobile HBs or HBs with improvised street pitches (it applies only to businesses working at home or with professional premises); c) this income criterion applies only to ‘located’ HBs (with professional premises).

Under the first hypothesis, 95% of IHBs should be registered in both cities (Table 2). If we relax the hypothesis by considering that only those with fixed premises fulfilling the income threshold should register, the share of ‘illegally’ operating IHBs drops significantly to around 70% under the loose definition of ‘premises’ (including homes), and dramatically to 10%-15% in the more restrictive case (considering only HBs with professional premises). These results merely reflect the fact that IHBs rarely operate on premises. ‘Manufacturing’ IHBs are the most advantaged in this respect (followed by ‘services’ and lastly ‘trade’, the most precarious). The figures are extremely close in the two cities. The only clear-cut conclusion to be drawn from this exercise is that HB registration legislation is unclear and all the more confusing for HB heads. This lack of transparency forms a breeding ground for discretionary decisions and for potential harassment and corruption by public officials.

Table 2. Registration and ‘legality’ in the informal sector (%)

		<i>Hypothesis: Income threshold applies to:</i>		
		<b>H1-</b> all kinds of HBs	<b>H2-</b> HBs at home or with professional premises	<b>H3-</b> only HBs with professional premises
		<b>Hanoi</b>		
<b>% of IHBs that should be registered</b>				
Manufacturing	95.9		90.0	7.3
Trade	93.1		60.3	21.8
Services	96.0		65.7	13.0
<b>Total IHB</b>	<b>94.9</b>		<b>68.1</b>	<b>15.2</b>
<b>% FHB*</b>	<b>2.7</b>		<b>5.5</b>	<b>42.0</b>
		<b>Ho Chi Minh City</b>		
<b>% of IHBs that should be registered</b>				
Manufacturing	95.4		93.8	6.0
Trade	93.4		64.0	16.0
Services	98.6		65.6	11.1
<b>Total IHB</b>	<b>95.4</b>		<b>71.3</b>	<b>11.6</b>
<b>% FHB*</b>	<b>2.4</b>		<b>3.8</b>	<b>40.8</b>

Note: \*: for FHBs, the reported figures are the % of HBs that are registered while it is not compulsory for them to be so.

Source: HB&IS Survey, Hanoi (2007), Ho Chi Minh City (2008), GSO-ISS/IRD-DIAL; authors’ calculations.

Turning to the FHBs, we ask why some HBs get a business licence when they do not have to. Based on the first hypothesis, less than 3% of FHBs earn less than the minimum wage, which means that they are complying with the legislation. However, if we consider that the income condition applies only to HBs with premises (or, in particular, industries), the diagnosis is quite different. For instance, under Hypothesis 3, more than 40% in both cities are registered

when they need not be. In this case, one interpretation could be that the cost/benefit analysis of registering leads HB heads to register in order to benefit from the expected advantages of operating in the formal sector.

Lastly, whatever the ‘true’ scope of the registration formalities, legislation and procedures should be clarified to eradicate the grey area between formality/informality and legality/illegality, which is a source of both economic inefficiencies and inequities.

#### 4. HB heads’ attitudes towards registration

In terms of business registration, there are two distinct situations that are, by definition, opposite: the situation of the IHBs, which are not registered, and the situation of the FHBs, which are registered. The vast majority of IHBs (72% in Hanoi and 79% in HCMC) believe that registration is not compulsory (Table 3). In addition to this huge proportion, 18% do not know whether they need to register in the capital city (7% in HCMC). All in all, regardless of the type of register considered (business, tax and social security registration), from 85% to 90% of IHBs are not aware of the regulations. It is therefore essentially ignorance of their legal obligations that leads the heads of IHBs to fail to register.

Neither the complexity nor the cost of the registration procedures appears to be a problem and there is no overt reluctance to cooperate with the public services. Only a tiny minority of less than 2% of IHBs openly refuse all cooperation with the State. Again, less than 2% of IHBs feel that the formalities are too complicated. Lastly, the monetary cost of registration is only raised by a maximum of 2% of those who have not registered. A not-inconsiderable proportion of IHBs (16% in Hanoi and 19% in HCMC) even say that they are willing to get a business licence.

Table 3. Reasons for not being registered (%)

	Reasons why not registered						Total	Prepared to register (business licence)	
	Too complicated	Too expensive	Registration in progress	Not compulsory	Don't know if have to register	Don't want to cooperate with State			Other
<b>Hanoi</b>									
Manufacturing	1.0	0.8	0.5	66.5	25.5	2.1	3.6	100	18.9
Trade	2.8	0.6	2.0	69.3	18.2	2.7	4.4	100	17.6
Services	1.0	0.6	0.2	76.5	14.1	2.0	5.7	100	14.1
<b>Total IHB</b>	<b>1.7</b>	<b>0.6</b>	<b>0.9</b>	<b>72.0</b>	<b>17.7</b>	<b>2.3</b>	<b>4.8</b>	<b>100</b>	<b>16.3</b>
<b>Ho Chi Minh City</b>									
Manufacturing	1.3	0.3	0.6	83.0	4.9	0.0	9.8	100	19.2
Trade	0.9	2.0	1.7	75.1	9.3	0.0	11.1	100	21.0
Services	0.4	1.7	1.2	80.1	7.1	0.2	9.4	100	18.4
<b>Total IHB</b>	<b>0.8</b>	<b>1.5</b>	<b>1.2</b>	<b>79.1</b>	<b>7.3</b>	<b>0.1</b>	<b>10.0</b>	<b>100</b>	<b>19.4</b>

Source: HB&IS Survey, Hanoi (2007), Ho Chi Minh City (2008), GSO-ISS/IRD-DIAL; authors’ calculations.

The qualitative survey conducted by the authors with HBs in Hanoi and Ho Chi Minh city assesses and illustrates the findings of the quantitative *HB&IS* survey (see Box). The analysis made in the previous section 3 showed that, if legislation were strictly enforced, almost all the

interviewed HBs would have to register. However, most of the informal HBs argue that their business is too small, claim that registration is not compulsory for them, and assert that nobody has asked them to register. Most of the informal HBs put forward the case of the small scale of their activity. The heads of HBs argue that they do not really run a business, just a 'household activity'. So, according to them, registration is not compulsory, though they acknowledge their limited knowledge of the legislation, which is clearly illustrated by their declaration.

The case of street vendors and service providers conducting their business in a public place like pavements and small lanes in the middle of a crowded neighbourhood merits special attention. Normally, they are not obliged to be registered, but they are banned in some streets. Due to both their personal circumstances and business conditions, those micro-entrepreneurs are not in a position to learn about and familiarize themselves with the laws concerning business registration. Not surprisingly, their limited knowledge of the regulations puts them in a difficult situation and is more problematic.

On the whole, IHBs stress the fact that they have never been controlled by the authorities: they have had no contact with public officials or no one has asked them to register. They have a small business located in a small street (mostly at home), so the authorities simply ignore them.

Informal activities therefore look to be more a sector of spontaneous development of economic activities by households rather than the result of a strategy to 'evade' legislation in force deemed inhibiting. The solution to the problem of non-registration in the informal sector calls first and foremost for an active communication policy by the State and probably for an administrative simplification of registration formalities. However, it would not be advisable to seek to indiscriminately increase tax pressure on the informal sector, given the meagre profitability of most IHBs.

### ***Reasons not being/being registered***

#### ***Illustration drawn from a qualitative survey in Hanoi and HCMC***

The findings presented in this article can be illustrated by some typical answers given by the informal HB heads on registration, along the three following lines. First, they justify their non-registration on the basis of their lack of knowledge of the legal obligation to register. Second, they declare that, due to a lack of control, they do not get the proper information on the legal framework and find no reason to register. Last of all, those which are not registered usually do not see any incentive to register.

#### **1. Lack of knowledge of legal obligations**

- *'I think that only big 'enterprises' need to register, my business is too small so there is no need for registration.'* (a rice and groceries seller);

- *'I think that my business involves no financial capital, only manual work. Only if I expand my business, I would be obliged register. 'To expand' is to grow and to become big in terms of capital, size, to hire additional employees, etc; then, it is required to register. I see that in this area, near the front road, there is a sewing workshop and they have to register.'* (a tailor);

- *'I learnt from my friends and acquaintances that small shops don't have to register as long as we sell no products like alcohol.'* (a seller of snacks and drinks);

- *'I think that to register, you need to visit the Department of Planning and Investment, yet I am not*

*sure about the whole procedure. My own business is non-registered because of its tiny scale (just I bus).’ (a bus rental);*

*- ‘This business is kind of ... on a basis of family tradition, we only do it at home.’... ‘Only HBs with a shop need to register.’ (a producer of copper products);*

*- ‘Only if your business has account books, has many clients, has earnings to pay employees and pay rentals’, then you have to register.’ (a lawyer);*

*- ‘I just manufacture goods, no trading here, thus no need to register.’ (a producer of aluminium and glass doors);*

*- ‘I don’t know the legislation. All I know is that when I see the police officers, I have to run away. If not, I will be harassed or pay some money.’ (a fruit seller - street vendor);*

*- ‘Whatever I do, I will be imposed a fine. I choose to stand on the streets where I can run quickly as the police officers come.’ (flower seller - street vendor).*

## **2. Absence of control**

*- ‘I did not register my activity because nobody asked me to register. The same goes for all the HBs operating in this street. I think it is a traditional street activity. That’s why the State does not ask for registration.’ (a metal door manufacturer);*

*- ‘I do not register because it is not compulsory. I run my business from home; it is not like other types of businesses.’ (a cake maker);*

*- ‘My business is not registered because I work at home. The local authorities consider that my house is a normal house, they do not ask any questions about my activity. It is not like shops in a big street.’ (a dressmaker);*

*- ‘It is a small business. I do not know much about the law. Administrative procedures are normally very complicated. Nobody asked me to register.’ (a tea and tobacco seller);*

*- ‘I do not know the law, but nobody asked me to register. Too bad for the State, good for me because if I had to register, I would have to pay taxes, buy specific protection equipment, it is complicated.’ (a plastic tube manufacturer);*

*- ‘I registered the trade activity in the shop where I sell the bread (as the shop front gives onto the street). Yet the manufacturing activity of making the bread (with about fifty wage workers, located on the corner of a small street) is not registered because the local authorities cannot control it.’ (a large informal bakery).*

## **3. Determinants/benefits of registration**

*- ‘Registration is compulsory for shops in streets where the local authorities usually have control over business activities. If HBs are not registered, the authorities impose penalties on them.’ (a paint seller with a shop in the street);*

*- ‘I am registered because it is compulsory for HBs that run a business in this market.’ (a fabric seller in a market);*

*- ‘If I compare my situation with other HBs which are not registered, I do not have to pay a special amount to the police (except monthly and annual taxes): policemen do not bother me.’ (a clothes seller located in a big street);*

*- ‘Officers from the local authorities asked me to register. If I had not registered, they would have come back regularly, almost every day. That’s worrying. So I decided to register. Still, there are some hairdressers who obstinately refuse to register.’ (a hairdresser located in a big street);*

*- ‘As regards registration, if a public official asked me to register, I would be prepared to do so. But, until now, nobody has asked me, so why should I register? Registration does not give you any advantages. On the contrary, it entails complicated administrative procedures and tax payment.’ (a*

plastic tube manufacturer);

- *'I found no advantages for HBs to be registered. Actually, registered HBs have more problems than unregistered ones since they have to deal with administrative formalities, taxes, rates, etc.'* (a hairdresser).

Source: Qualitative survey, Hanoi and Ho Chi Minh City, 2007 & 2009, GSO-ISS/IRD-DIAL

The views of the formal household businesses are particularly interesting when it comes to the potential advantages of registration (Table 4). The main benefit they see in registration is to avoid corruption (70% in Hanoi and 57% in HCMC), which suggests that the risk of corruption is perceived as being particularly high (which does not mean that actual corruption is; see below). The other two advantages they see in registration, although way behind the first, are access to better locations and the possibility of winning contracts with large firms. All in all, the vast majority recognize that being registered is positive: only 2% of FHBs in Hanoi and 14% in HCMC consider there is no advantage in being registered.

The informal sector, which is not registered, also sees reducing the risk of corruption as a major incentive for registration: 32% of IHBs in Hanoi and 28% in HCMC share this point of view, which confirms the importance of this issue. Nevertheless, nearly 50% in both cities consider that there is no point in registering, suggesting that registration gives household businesses few advantages. This huge gap between the real advantages of registration perceived by HBs already registered and the low expectations of IHBs suggests that more effort should be put into informing IHBs about the potential rights gained by registering their activity.

Table 4. Opinion and experience of business registration procedure in the informal sector (%)

	Main advantage of registering business						No Advantage	Total
	Access to loan	Access to market place	Sale to large firms	Advertising	Face less corruption	Other		
<b>Hanoi</b>								
Manufacturing	8.9	13.2	4.8	2.4	29.5	2.2	39.0	100
Trade	5.0	10.2	4.3	0.6	32.1	1.8	46.0	100
Services	4.9	8.7	1.5	1.1	33.2	5.0	45.6	100
<b>Total IHB</b>	<b>5.7</b>	<b>10.0</b>	<b>3.2</b>	<b>1.2</b>	<b>32.1</b>	<b>3.3</b>	<b>44.5</b>	<b>100</b>
<b>Total FHB</b>	<b>3.3</b>	<b>14.9</b>	<b>6.7</b>	<b>1.9</b>	<b>69.7</b>	<b>0.5</b>	<b>2.8</b>	<b>100</b>
<b>Total HB</b>	<b>5.2</b>	<b>11.0</b>	<b>3.9</b>	<b>1.3</b>	<b>39.4</b>	<b>2.8</b>	<b>36.4</b>	<b>100</b>
<b>Ho Chi Minh City</b>								
Manufacturing	3.1	13.2	5.5	1.2	29.4	10.1	37.4	100
Trade	4.3	11.8	2.9	0.3	23.2	5.1	52.5	100
Services	2.3	7.6	0.7	0.4	30.6	5.8	52.6	100
<b>Total IHB</b>	<b>3.1</b>	<b>10.2</b>	<b>2.5</b>	<b>0.5</b>	<b>28.0</b>	<b>6.5</b>	<b>49.2</b>	<b>100</b>
<b>Total FHB</b>	<b>3.9</b>	<b>15.4</b>	<b>5.0</b>	<b>0.7</b>	<b>56.6</b>	<b>4.8</b>	<b>13.7</b>	<b>100</b>
<b>Total HB</b>	<b>3.3</b>	<b>11.5</b>	<b>3.1</b>	<b>0.6</b>	<b>35.2</b>	<b>6.1</b>	<b>40.2</b>	<b>100</b>

Source: HB&IS Survey, Hanoi (2007), Ho Chi Minh City (2008), GSO-ISS/IRD-DIAL; authors' calculations.

Formal HBs (i.e. registered) are mainly those with professional premises (or a fixed location in a market) located in busy streets. Most of them are engaged in 'trade' (or 'services' such as a coffee shop). Their business is a visible one and provides a fairly high level of income (see

Table 1 above). When the interviewer of the qualitative survey asked why they had decided to become formal, they said that it is compulsory and they have to register to avoid trouble with the authorities. According to them, they face less trouble with public officials if they are registered.

Nevertheless, some informal HBs are not really small and some of their characteristics are similar to formal HBs (high income in a busy street). So the reason why some HBs have to comply with the law (under pressure from public officials) while others are not concerned by the law is not totally clear. The former (the formal HBs) might just be the ones chosen by the public officials to be controlled and which decided to avoid problems leading to the payment of fines or gifts many times a year. Therefore, location appears to be a key variable. The HBs that prove to be the potential targets of controls are those that can be easily spotted and/or show enough external signs of wealth. In many cases, it is hard to imagine that the public officials are not aware of the existence and scale of the HBs' activities.

So even though most of the HBs do not specifically try to evade paying tax, for some HBs, it is the main reason why they have not registered. However, for the latter, it seems that their strategy is based less on a real intent to completely conceal their activity than on the opportunity of making the most of lax law enforcement and ineffective control. Most of the informal HBs declare that they would be prepared to register their activity should it prove to be compulsory. This finding confirms the fact that they do not deliberately intend to be outside the law. However, they are prepared to do so if there are some incentives like specific public support to expand their business (access to credit, premises, information, training, etc.).

Many HB heads stressed the fact that becoming formal does not provide any advantages. Far from it, in fact, as heads of HBs merely have to pay more taxes and procedures are complicated. Those who register their business are the most visible ones. As they are subject to some sort of control by the authorities, they decide to comply with the law instead of paying regular 'gifts' to public officials. While some informal HBs pay taxes like the formal ones, the majority do not pay any taxes. HBs do not know how taxes are calculated and see them as being set in an arbitrary fashion (following negotiations between the HB head and the public official). Moreover, in addition to taxes, a large number of HBs have to periodically give a not-inconsiderable amount of money to public officials. The borderline between fines, "voluntary contributions" and corruption is not always clear for the HB heads, so this form of payment has become normal for them.

## **5. What are the explanatory factors behind registration?**

The *HB&IS* Survey has the advantage of capturing both formal HBs and informal HBs at the same time. We propose here using an econometric estimation to study more in detail why some production units register and others do not. By estimating simple probit models, we do not pretend to tackle endogeneity issues (given our cross-section surveys, no credible instruments are at hand), but to find significant associations. The purpose of this is to identify different types of factors (correlates) and analyze the extent to which they may have influenced business heads' decisions to become formal. This clarification rounds out the

analysis presented above in this paper and the qualitative approach presented in Box 1. The explanatory factors can be classed into three categories:

- The first factors are those directly related to the legislation in force;
- The second category covers individual factors associated either with the production unit heads' characteristics ('head of household business') or, in a corollary way, with the reasons why they set up the units;
- The third category concerns the incentives.

Tables 5, 6 and 7 present the results of our econometric estimations taking into account these three different kinds of factors. The Pseudo-R<sup>2</sup> continually increases when we add explanatory factors: it is 0.10 only when we take into account three factors related solely to legislation (size, number of wage workers and value-added); and it increases when we add factors related to the HB heads' characteristics (Table 6). The Pseudo-R<sup>2</sup> reaches its maximum level when the three categories of factors are taken into account in the model (Table 7).

### **5.1 *Legislation-driven factors***

Bear in mind that HBs meeting a certain number of criteria theoretically have to register. Although the definition of these criteria and how they are enforced remains somewhat vague, they do concern three HB characteristics: income generated (if the income they generate exceeds a given threshold); type of premises (roving activities do not have to register); and type of business (some activity sectors are subject to special controls). If the law were strictly enforced, these characteristics would be enough to explain why some HBs are formal (registered) and others are informal (unregistered). However, in keeping with the previous analyses, our econometric results find this to be far from the case.

The model's findings (Table 5) show that HB incomes, as well as size, are positively and significantly correlated with the registration decision. The probability of registering increases with the annual value-added generated by the units or with their size (number of workers). The question could be asked as to the direction of the causality for these two variables. Did the HB's level of business lead its head to register? Or did the fact of being registered enable the business to grow? Based on panel data of Vietnamese manufacturing SMEs, Rand and Torm (2012b) conclude that formalizing is beneficial both to firms and the workers in these firms. However, in both cases, concern to comply with the law (at the time of registration or before) could well have played a role. Note that the legislation does not directly consider HB size (number of persons working in the unit) as a criterion (except for units employing more than ten people, which must then register pursuant to the Law on Enterprises). Yet size is closely correlated with the level of business and is easier to measure reliably than income generated (or value-added). Secondly, the larger the units, the more visible they are and therefore the more likely they are to be controlled by public officials, forcing them to register. Moreover, given identical business size, the probability of registration would appear to decrease with the number of employees (all the HBs are made up of an HB head accompanied, where applicable, by family workers and employees). This finding could reflect

a will to dodge the obligation to register these employees with social security, a hypothesis consistent with Castel and To's results (2012) on formal enterprises.

In terms of activity sectors, the law singles out mainly roving businesses (which are exempt) and a few specific activities calling for strict controls (health and safety: sale of food products, pharmaceuticals, gas, etc.), which are legally bound to register. So, aside from these few specific activities, we might expect to find relatively homogeneous behaviour in terms of registration. Yet the probability of registering varies a great deal from one sector to the next. Manufacturing activities (textiles, manufacture of food products, etc.) and especially HBs in the “construction” sector turn out to be the least inclined to register. Service activities are in a mid-range position, but the probability of their being registered remains lower than roving traders. Trade businesses are the most liable to comply with the law. Of these, in keeping with the legislation, wholesale traders and retail traders set up in specific stores are more likely to register as formal businesses than roving traders.

Lastly, the type of premises plays a decisive role in registration. The decision to register is found much more frequently among HBs with professional premises and is much scarcer among HBs without fixed business premises. HBs that run their business from home are found between these two extremes.

Table 5. Explanatory factors for HB registration: legislation-related factors

	(1)	(2)	(3)	(4)
Size (Total number of workers)	0.5*** (9.991)	0.5*** (9.676)	0.5*** (9.676)	0.4*** (7.130)
Number of employees	-0.3*** (-6.998)	-0.3*** (-5.217)	-0.3*** (-5.217)	-0.2*** (-4.109)
Value-added (annual)	0.0*** (7.664)	0.0*** (6.600)	0.0*** (6.600)	0.0*** (6.328)
<i>Sector (reference: outside retail store)</i>				
Textile, leather, shoes		-0.4*** (-2.975)		
Food processing & other manufacture		-0.3** (-2.478)	0.1 (0.643)	0.1 (0.414)
Construction		-2.1*** (-5.773)	-1.7*** (-4.554)	-1.4*** (-3.714)
Wholesale trade		0.3** (2.126)	0.3** (2.126)	0.3* (1.696)
Retail trade professional stores		0.6*** (5.946)	0.6*** (5.946)	0.5*** (4.672)
Hotel accommodation		-0.4*** (-3.833)	0.1 (0.476)	-0.4*** (-2.636)
Repair service		-0.2 (-1.038)	0.3* (1.766)	-0.4* (-1.822)
Transport service		-0.5*** (-3.499)		
Other services		0.1 (1.194)	0.6*** (4.578)	-0.1 (-0.645)
<i>Industry (reference: services)</i>				
Manufacturing & construction			0.1 (0.354)	-0.5*** (-2.793)
Trade			0.5***	-0.1

			(3.499)	(-0.837)
<i>Type of premises (ref.: outdoor premises)</i>				
Professional premises				1.8*** (16.30)
Premises at home				1.0*** (9.454)
Intercept	-1.5*** (-20.87)	-1.5*** (-13.99)	-2.0*** (-16.05)	-2.3*** (-15.82)
Observations	2,637	2,637	2,637	2,637
Pseudo R2	0.10	0.19	0.19	0.31
Log-likelihood	-1,360	-1,223	-1,223	-1,046

Note: Probit estimation. z statistics in parentheses.

\*\*\* coefficient significant at the 1% level. \*\* significant at the 5% level. \* significant at the 10% level.

Source: HB&IS Survey, Hanoi (2007), Ho Chi Minh City (2008), GSO-ISS/IRD-DIAL; authors' calculations.

## **5.2 *Individual factors***

With respect to the HB heads' characteristics, firstly, the level of education significantly influences their behaviour with regard to the legislation. The most well-educated are more inclined to register. They are better informed, more able to handle the procedures and more ambitious when it comes to developing their business. Secondly, women seem less willing to register the businesses they run, but the significance of the coefficient is small (Table 6). This finding could be due to their attitude to their activity, which they do not see as a real 'business', but as an 'auxiliary' activity. In line with this logic, the reasons why the HBs were set up also influence the registration decisions. Businesses set up to be independent or to follow a family tradition display a greater probability of being formal compared with those set up for lack of an alternative (for want of a wage job) or to make extra income for the household (auxiliary activity). Therefore, the formal or informal nature of a business would appear to be determined right from its creation. Consistently, the number of years in business apparently has no impact on registration, confirming that many HBs are stuck in an 'informality trap'. Lastly, migrants, more vulnerable and less confident about how long their businesses will last, are less likely to register them. All these findings are in line with the literature which stresses that micro firms' dynamics (like formalization and economic performance) are highly dependent on the reason for setting up the business: the more it is a real choice (and the less a constraint), the more the HB is economically efficient (Perry et al., 2007).

## **5.3 *Incentives***

The unit heads (formal and informal) were asked about the advantages they could gain from registering their businesses. The incentives they mentioned prove decisive insofar as, other things being equal, the probability of having a formal business is greater among those who mention them (compared with those who raise no advantages). Access to credit is one exception since it could potentially be facilitated by registration, but this benefit is not confirmed by the registered HBs (Table 7). However, access to markets, the possibility of developing relations with large firms and the possibility of becoming known all appear to have influenced the unit heads' decisions to register. Similarly, one of the factors mentioned the most by the formal HBs is that registration means they are less exposed to corruption. Turning from opinion to experience, being actually affected by corruption is a significant factor in favour of formalizing the business, confirming that registration may be an effective way to reduce corruption.

These findings are paradoxical in that formal HBs are also the hardest hit by corruption (see Table A in annex). To solve this paradox, we have studied the cross effects of the two variables (actual experience of corruption, on the one side, and saying that registration reduces corruption, on the other). The results show that registration is positively and significantly correlated with mentioning this advantage, irrespective of whether the HBs are victims of corruption or not. So registration provides at least partial protection from corruption (as the HBs feel they would be harder hit if they were informal).

Table 6. Explanatory factors for HB registration (with individual factors)

	(5)	(6)	(7)
Size (total number of workers)	0.3*** (6.247)	0.3*** (6.209)	0.4*** (6.619)
Number of employees	-0.2*** (-3.724)	-0.2*** (-3.878)	-0.3*** (-4.543)
Value-added	0.0*** (6.786)	0.0*** (6.667)	0.0*** (6.120)
<i>Industry (reference: service)</i>			
Manufacturing & construction	-0.4*** (-3.891)	-0.4*** (-4.004)	-0.4*** (-3.504)
Trade	0.4*** (6.403)	0.4*** (6.179)	0.5*** (6.700)
<i>Type of premises (ref.: outdoor premises)</i>			
Professional premises	1.5*** (12.33)	1.5*** (12.07)	1.4*** (10.98)
Premises at home	0.6*** (5.128)	0.6*** (5.060)	0.5*** (4.151)
<i>Owner of premises (ref.: squatted or other)</i>			
Own premises	0.7*** (5.268)	0.7*** (4.827)	0.7*** (4.872)
Rented premises	0.6*** (4.715)	0.6*** (4.273)	0.6*** (4.430)
Nb years existence	0.0 (0.856)	0.0 (0.777)	0.0 (1.362)
Household main client	-0.2** (-2.153)	-0.2** (-2.067)	-0.2* (-1.899)
<i>Reason for setting up HB (ref.: no job as wage worker)</i>			
Reason: to get higher income		0.1 (1.128)	0.1 (0.983)
Reason: to be independent		0.5*** (5.330)	0.5*** (5.408)
Reason: family tradition or other		0.2* (1.766)	0.2* (1.817)
<i>Characteristics of HB head</i>			
Female			-0.1* (-1.915)
Education: lower secondary (ref.=primary)			0.3** (2.260)
Education: upper secondary (ref.=primary)			0.6*** (5.478)
Education: university (ref.=primary)			0.8*** (5.861)
Migrant			-0.4** (-2.147)
Intercept	-2.6*** (-15.41)	-2.8*** (-15.67)	-3.1*** (-15.20)
Observations	2,636	2,636	2,636
Pseudo R2	0.30	0.31	0.34
Log-likelihood	-1,056	-1,039	-1,004

Note: Probit model. z statistics in parentheses. \*\*\* p<0.01, \*\* p<0.05, \* p<0.1

Source: HB&IS Survey, Hanoi (2007), Ho Chi Minh City (2008), GSO-ISS/IRD-DIAL; authors' calculations.

Table 7. Explanatory factors for HB registration (with incentives)

	(8)	(9)	(10)
<i>Reason for setting up HB</i> (ref: no job as wage worker)			
Reason: to get higher income	0.1 (1.151)	0.1 (0.908)	0.1 (0.898)
Reason: to be independent	0.5*** (4.982)	0.5*** (4.967)	0.5*** (4.973)
Reason: tradition or other	0.3** (2.421)	0.3** (2.283)	0.2** (2.265)
<i>Characteristics of HB head</i>			
Female	-0.2** (-2.103)	-0.1* (-1.726)	-0.1* (-1.717)
Education: lower secondary	0.2** (2.112)	0.2** (2.040)	0.2** (2.054)
Education: upper secondary	0.6*** (5.115)	0.6*** (5.082)	0.6*** (5.084)
Education: university	0.8*** (5.221)	0.8*** (5.169)	0.8*** (5.188)
Migrant	-0.3 (-1.636)	-0.3 (-1.516)	-0.3 (-1.507)
<i>Incentives (advantage of registration according to the HB head)</i>			
Reference='no advantage'			
Advantage: access to credit	0.3 (1.451)	0.3 (1.505)	0.3 (1.513)
Advantage: access to market	0.6*** (5.506)	0.7*** (5.484)	0.7*** (5.492)
Advantage: access to big firm	0.8*** (4.401)	0.8*** (4.484)	0.8*** (4.507)
Advantage: advertising	1.0*** (3.017)	1.0*** (2.935)	1.0*** (2.913)
Advantage: other	0.7*** (3.950)	0.7*** (3.786)	0.7*** (3.754)
Advantage: less corruption	1.1*** (11.85)	1.1*** (11.69)	
Victim of corruption		0.6*** (4.125)	0.7*** (3.295)
'Adv. less corruption'*'victim of corruption'			0.9*** (3.161)
'Adv. less corruption'*'Not victim of corruption'			1.1*** (11.61)
Intercept	-3.8*** (-16.50)	-4.0*** (-16.60)	-4.0*** (-16.63)
<b>Controls: legislation + individual characteristics</b>			
Observations	2,636	2,636	2,636
Pseudo R2	0.39	0.40	0.40
Log-likelihood	-918	-910	-910

Notes: Probit model. z statistics in parentheses

Coefficients for the factors related to the legislation, the owner of the premises and the type of customer are not reported here since they remain unchanged (see model (7) in Table 6).

\*\*\* coefficient significant at the 1% level. \*\* significant at the 5% level. \* significant at the 10% level.

Source: HB&IS Survey, Hanoi (2007), Ho Chi Minh City (2008), GSO-ISS/IRD-DIAL; authors' calculations.

## 5. Conclusion

It has often been claimed that informality is caused by an excess of public regulations, especially steep rates of taxation in the formal sector, and the deliberate will on the part of informal set-ups to evade the legislation (i.e. the abovementioned ‘legalist’ approach). This theory is partially refuted in the case of Vietnam. All in all, regardless of the type of register considered (business, tax and social security registration), almost all the IHBs are unaware of the regulations. This situation is consistent with the results obtained by Tran Tien Cuong *et al.* (2008) based on a large sample of household businesses surveyed in more than ten Vietnamese provinces. It is therefore essentially ignorance of their legal obligations that leads the heads of informal household businesses to fail to register.

In general, IHBs benefit from the haziness surrounding the issue of registration regulations. Even though this behaviour is partly involuntary (little understanding of the laws), informality does mean they evade taxes and certain regulations. We observe here a combination of characteristics in keeping with the ‘dualist’ (see above regarding earnings and labour protection) and ‘legalist’ approach, although the latter is only really confirmed for a small number of IHBs. Indeed, although they pay less taxes, most IHBs consider that they would be less subject to corruption if they registered. In addition, the reasons why the HBs were set up also influence the registration decisions. Businesses set up to be independent or to follow a family tradition (reflecting a positive choice) have a greater probability of being formal compared with those set up for lack of an alternative (for want of a wage job) or to make extra income for the household (‘auxiliary activity’). Panel data analysis (now available with a second round of *HB&IS* Surveys) may be a useful avenue to strengthen our econometric results, by controlling for time invariant unobservables and better addressing endogeneity issues.

To conclude, some policy implications may be drawn. All in all, it appears that the informal sector has not yet really attracted the attention it deserves from the Vietnamese authorities. A vast majority of informal household businesses believe that registration is not compulsory, in spite of the fact that our analysis underlines that most of them should be registered according to the regulations. In general, formalising IHBs is seen as a way of increasing government revenues (by taxing those IHBs not previously subject to the tax) and improving IHBs’ operating conditions and earnings. In Vietnam, IHB registration does not appear to be perceived as difficult (World Bank 2011). The priority is therefore, first and foremost, to put in place formalization incentives, which could take the form of granting special advantages (access to credit, social protection, access to professional premises, etc.). Given that our analysis shows that some HBs are informal by choice on the basis of a cost-benefit calculation of formalization, this means changing their trade-off terms.

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## ANNEX

Table A. Descriptive statistics on household businesses (%)

	Hanoi		HCMC	
	IHBs	FHBs	IHBs	FHBs
<b>Individual HB head characteristics</b>				
-Women	53.5	51.3	57.8	53.9
-Number of years of schooling	9.5	11.2	7.9	9.9
-Migrant	1.0	1.7	8.0	4.0
<b>Main reason for setting up an HB</b>				
-Did not find wage-earning work	30.6	13.8	18.9	6.4
-Did not find wage-earning work in HB	11.9	6.5	11.1	2.4
-To get a better income	28.8	33.9	14.7	18.3
-To be independent (own boss)	14.2	31.0	34.1	54.4
-By family tradition	2.6	10.5	7.4	12.5
-Other	11.8	4.4	13.7	6.1
<b>Pay taxes</b>				
-Business tax	16.4	88.1	1.6	78.4
-Income tax	1.7	28.0	1.1	57.0
-Local taxes	23.1	21.6	12.6	18.5
<b>Victim of corruption</b>				
-Incidence of corruption	4.5	7.4	1.6	4.4
-(In event of problem) paid a fine	15.8	14.1	9.6	20.1
-(In event of problem) paid a bribe	14.2	27.0	13.0	19.8

Source: HB&IS Survey, Hanoi (2007), Ho Chi Minh City (2008), GSO-ISS/IRD-DIAL; authors' calculations.

<sup>1</sup> The authors conducted a research programme in Vietnam as members of the DIAL team (Development, Institutions and Globalisation) from the French Institut de Recherche pour le Développement (IRD) in collaboration with the General Statistics Office (GSO) from 2006 to 2011.

<sup>2</sup> The HB&IS Survey was conducted before the government's decision to expand Hanoi province, which was put into effect in August 2008. According to the 2009 Population Census, which included 'greater Hanoi', the population of the country's capital (6.5 million inhabitants) is now almost equal to HCMC (7.1 million).

<sup>3</sup> On average, 1USD=16,000 VND in 2007.