

Vietnam's Regional Economic Linkages and Industrial Competitiveness: An Analysis and Case Studies of the Textile and Garments, Electronics and Automotive Industries

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I. INTRODUCTION

The Renovation (*Doimoi*) in 1986 and especially the market-oriented reform in 1989 marked a turning point in history of Vietnam's economic development. Vietnam adopted a radical and comprehensive reform package aimed at stabilizing and opening the economy, and enhancing freedom of choice for economic units and competition so as to change fundamentally its economic management system¹. During 1997-2000, however, the implementation of the reforms has slowed down, especially after Asian financial crisis. However, beginning 2000, a new wave of economic reform has stirred with more policy actions on the development of private sector, further trade and investment liberalization together with deeper international economic integration. Meanwhile, the reform of the state-owned enterprises (SOEs), financial system, and public administration were slower than expected and this limited the effectiveness and efficiency of other reforms.

In tandem with economic reform and the government's "open door policy," international economic integration has played a key role in enhancing efficiency and promoting economic growth. In 1992, Vietnam signed a trade agreement with the European Union (EU) and in 1995, joined ASEAN and committed to fulfill the agreements under the AFTA by 2006. Vietnam applied for WTO membership in 1995 and is expected to be a member by the end of 2005. In 1998, Vietnam became a member of the APEC. Two years later, Vietnam signed the Bilateral Trade Agreement with the United States (VN-US BTA) and the Agreement became effective in December 2001. Most recent, Vietnam has also joined regional integration clubs such as ASEAN-China Free Trade Area (2003) and the ASEAN-Japan Comprehensive Economic Partnership (2003).

Vietnam escaped from the crisis in the mid-1980s and since then the face of Vietnam's economy and society has changed significantly. The overall goal of Vietnam's Socio-Economic Development Strategy 2001-10 is to accelerate industrialization and modernization in order to bring Vietnam out of underdevelopment and create a strong economic foundation so that by 2020 Vietnam will basically become "a modern-oriented industrialized country" (CPV 2001). The realization of this goal obviously cannot be achieved without successful linkages with regional and global networks, an appropriate structural adjustment and a considerable improvement of the competitiveness of Vietnamese economy.

This report is about the position and industrial competitiveness of Vietnam's economy in the East Asian production network. Section II gives a brief review of Vietnam's approach to the strategy of development and industrialization in general and its trade and industrial policies in particular. Section III describes the structural changes in terms of industrialization with

¹ The reforms included:

- Almost complete price liberalization;
- Large devaluation and unification of the exchange rate;
- Increases in interest rates to positive levels in real terms;
- Substantial reduction in subsidies to the SOE sector;
- Agricultural reforms through replacement of cooperatives by households as the basic decision-making units in production and security of tenure for farm families;
- Encouragement of the private sector, including foreign direct investment (FDI);
- Removal of domestic trade barriers and creation of a more open economy.

international comparisons and through regional trade and investment linkages. Section IV analyzes Vietnam's industrial competitiveness based on the international competitiveness coefficient index, the dualism of the economy, and the production value chains. Section V concludes the report with remarks on policy option alternatives. Within the framework of this report, case studies of the textiles and garment, electronics, and automotive industries are presented as appendices as illustrative examples for our analyses. The case studies take into account the responses to the authors' interviews by the directors/managers of some companies' in three industries².

II. VIETNAM'S STRATEGIC DEVELOPMENT VIEW AND INDUSTRIAL AND TRADE POLICIES

In terms of a strategic view on the future direction of economic development policy, Vietnam has stressed a necessity for building a market economy with an orientation towards socialism. There has also been a consensus in Vietnam with regard to the needs of structural reforms in SOEs, the financial system, human resource development, infrastructure, public administration, and international integration. Other than that, the trade and industrial policies have been driven by a "picking-the-winner approach" on the one hand, and export-promotion, on the other. While recognizing economic globalization as "an inevitable trend" and the Asia-Pacific region as a dynamic development area, in which China will play an increasingly important role, Vietnam has also emphasized the importance of building an independent and self-reliant economy. Moreover, the state sector should play a leading role in the economy and a monopolized role in some key sectors. The SOEs are now seen not only as profit-maximizing agents, but also as a material force for stabilizing the economy.

Vietnam's approach to development and industrialization has been reflected in industrial, trade, and FDI attraction policies. The Socio-Economic Development Strategy 2001-10 sets the targets on building "some selected important heavy industrial establishments³ with high technology, which produce the necessary means of production to equip and re-equip advanced techniques and technologies for the whole economy and to meet national defense requirements." At the same time, the Strategy seeks to mobilize "all possible resources to achieve a rapid and effective development of products, sectors and industries⁴ that have comparative advantages in order to basically meet domestic demand and promote exports" (CPV 2001). Vietnam expects to achieve high value added industrial growth (10-10.5% annually during 2001-10) and even determines quantitative targets for some industries. By 2010, the economy will produce 69-71 billion kWh, 34-35 million tones of oil equivalents, 12 million tons of petrol, 17-19 million tons of clean coal, 2.0-2.2 million tones of nitrogenous fertilizer, 4.0-4.5 million tones of steel, 30-32 million tones of paper, 0.9-1.0 billion meters of cloth, and meet 40% of the domestic demand for mechanical products (see also Table 1). With regard to the efficiency of state investment, it is still regarded as a key ingredient for ensuring high economic growth. The investment share of the state sector in total investment was up sharply from 35% in 1991 to about 57% during 2000-04⁵. According to the public investment program for 2001-05, the state investment accounts for 59.3% of total investment during 2001-05 (CIEM 2003b).

² The interviews were conducted in August and September 2004.

³ Such as petroleum, metallurgy, basic chemicals, fertilizers, construction materials, cement

⁴ Such as agriculture, fishery, garment, footwear, electronics, some mechanics and consumption goods

⁵ The state investment consists of investment from state budget, state credit (including ODA), and investment capital by the SOEs. (CIEM 2004a and 2004b)

Table 1: Some Targeted Indicators for Industrial Development, 2001-2010

Indicators	2000	2001-2005	2001-2010
Growth rate of GDP	6.8	7.5	7.5
Industrial gross output structure*, (%)	100	100	100
Mining	13.6	13.6	10.7
Basic industries,	29.0	33.6	41.1
of which: Chemical engineering	11.2	13.9	18.7
Metal processing	3.0	2.6	3.5
Electronics and IT	5.2	6.9	8.5
Chemicals	9.6	10.2	10.4
Agricultural products processing	19.2	23.9	20.5
Garment and footwear	12.4	12.9	13.8
Construction materials	8.9	8.9	7.6
Electricity, water, gas	5.9	6.2	5.5
Others	1.2	0.9	0.8

Source: All figures are from the Social-Economic Development Strategy 2001-10 and the Socio-Economic Development Plan 2001-2005, which were officially approved. Only * is from the Industrial Development Strategy up to 2010, which was drafted by Ministry of Industry but not yet approved. However, this projection was based on the targeted growth rate of value added of the industry and construction targeted in the Social-Economic Development Strategy 2001-10.

Vietnam's trade regime has been gradually liberalized since 1989. The monopoly position of SOEs in foreign trading activities has been steadily weakened and the abolishment of trade licenses in 1998 (and further relaxation in 2001) was a significant step towards liberalization. The number of enterprises registered for trading activities increased from 2,400 in early-1998 to more than 18,000 in 2003. However, during 1997-99, regulatory changes, especially those related to non-tariff barriers (NTBs) and practical implementation can be seen as a process of "two steps forward and one step back." The years 2000-04 witnessed major positive changes in trade policy. First, a trade policy roadmap for the period 2001-05 (Decision 46/2001/QD-TTg in April 2001) was announced for the first time in place of the earlier practice of announcing one-year regimes, making a more transparent and predictable export-import environment. In particular, most quantitative restrictions were removed in 2001, ahead of schedule, and at present there are only two products, petroleum and sugar, subject to quantitative restrictions. Furthermore, the foreign exchange surrender requirement was reduced gradually from 80 percent in 1998 to 50 percent in 1999, 40 percent in 2001, 30 percent in 2002 and 0 percent in 2003.

Vietnam has also mostly fulfilled its commitments under AFTA. In 2003, the number of items in the Inclusion List (IL) accounts for 97.1% of total tariff lines (compared to that of about 39% in 1996). Their maximum tariff rate reduced from 50% in 2000 to 20% in 2003 (It will be further lowered to 5% in 2006). Among the ASEAN countries, however, Vietnam still has the highest number of items in the Temporary Exclusion List (TEL) and in the Sensitive List (SL) (CIEM 2004a). The VN-US BTA covers commitments in a wide range of issues, which are in conformity with WTO norms, such as trading rights, tariffs, quantitative restrictions, intellectual property rights, liberalization in some service sectors, trade-related investment measures, and transparency. Since the formal application for WTO membership in 1995 up until now, Vietnam has held 9 rounds of negotiations. The 8th round of negotiations in June 2004 is seen to have an important breakthrough step. The WTO members negotiating a membership package with Vietnam supported Vietnam's objective of joining the WTO "as soon as possible." The members worked through the "elements" of a draft report and a proper first draft report was discussed during the 9th round of negotiation in December 2004. Vietnam's efforts now focus on bringing domestic laws in line with WTO practices and undertaking bilateral WTO negotiations with a hope to be a WTO member by the end of 2005. Recently, Vietnam has also joined different

regional integration clubs such as ASEAN-China Free Trade Area and ASEAN-Japan Comprehensive Economic Partnership as it would like to get benefits from regional trade and production network.

However, Vietnam's trade regime has operated within a rather comprehensive framework of regulations on trading rights and trade barriers with efforts to promote exports as well as to protect import-substituting production. In recent years the tariff structure has not changed much, even though the trading right has been liberalized to a very significant extent and the coverage of NTBs has been reduced substantially. Although the average rate of all tariff lines is not high compared to many developing countries and the low tariffs cover a big share of imported items, the imported items and the state budget revenue from tariffs have mainly concentrated in the items with the rates of 20% or more.

Moreover, the tariff structure has been characterized by heterogeneity and high dispersion, in which the high tariffs have been generally applied on several finished or consumer goods. This means that several industries have had high levels of effective rates of protection (ERP) (Table 2)⁶. The level of manufacturing effective protection in Vietnam, though significantly declining, is still higher compared to the major East Asian economies and even higher than that enjoyed by the Korean manufacturing at the early stage of export-led industrialization (Athukorala 2004).

Table 2: Effective Rates of Protection by Sector, 1997-2003

Sector	1997	1999	2001	2003
Agriculture	7.7	7.6	7.4	14.7
Mining	6.1	17.7	16.4	0.03
Manufacturing	121.5	82.6	96.0	46.3

QR inclusive estimates.

Source: Athukorala (2004) and Nguyen Thang (2002)

Import protection is considered to be a tax on export-competing production. In order to promote exports, Vietnam has implemented several measures such as zero export duty, tax exemption, export credit, and especially duty drawback scheme. The natural question, then, is whether there is still bias against exports. By using the export bias index, the study by Athukorala (2004) has shown that while various measures to counterbalance the anti-export bias of the protectionist regime seem to have some effects, they are unlikely to achieve the desired neutrality in the incentive structure. There is even a considerable bias against exports in several sub-sectors where Vietnam has an ample scope of achieving export success such as garments, plastic products, leather goods, ceramics and other manufacturing.

Recognizing the important role of FDI, the Vietnamese government has paid significant efforts in creating a favorable environment for doing business in Vietnam. The amended Constitution in 2001 confirmed that FDI is an integrated part of the national economy and should enjoy equal incentives as other sectors in the economy. Since the Law on Foreign Investment in 1987 was enacted, the government has been made continuous improvement in foreign investment regulations in order to attract foreign investors to Vietnam. The Law was amended four times in 1990, 1992, 1996 and 2000 (Dinh Van An et al 2003). Accordingly, investment

⁶ The estimation of the ERPs is for import-substituting firms. Note that for export-oriented firms, as their products go to the world market and therefore cannot be protected (tariffs are zero). The ERPs calculated for some export-oriented industries may overstate the degree that these activities are penalized by the trade regime.

areas wherein foreign investors are allowed to do business are being expanded, including services. Foreign investors in Vietnam have also been given more rights and fewer requirements, including those regarding start-up procedures. The government shortened the list of FDI projects that required export of 80% of the production output in 2002; allowed foreign investors to use land for mortgage and to recruit labor; and expanded the business forms of FDI and trade rights, among others. Resolution Number 9 issued by the government in 2001 requires hastening the elimination of the dual price system for almost all charges and fees, further expansion of FDI in some sectors such as agribusiness, fisheries, retail sales and distribution. Another decision in March 2003 also regulated the investment of foreign investors in the contributing capital of Vietnamese firms as well as the purchase of shares in these firms. These investors are now allowed to acquire up to a 30% stake in all forms of Vietnamese companies, which creates more channels in which foreigners could invest. At present, the government is aiming to establish a level playing field for both domestic and foreign investors. There is hope that FDI inflows, especially those from Japan, would surge in coming years as the Vietnam-Japan Investment Protection Agreement (2003) will be effectively implemented and Vietnam will soon become a member of WTO.

During the 1990s, Vietnam's policy had focused on (fiscal) incentives rather than creating a neutral policy environment for attracting FDI⁷. Vietnam now seems to be on a more prudent track with a more liberal and neutral environment. Experience has shown that FDI involves a longer-term commitment, which will be based on future and sustained profits. Case studies of FDI in APEC countries pointed out that site selection of FDI is less a function of the incentives offered to them than hope that is offered by the economies (Economic Committee 1997). The major obstacles are, however, still there: cumbersome administrative procedures and corruption, inconsistent and barely transparent system of legal documents, and unpredictability of policy changes. In the eyes of Japanese investors, "Vietnam is still a country somehow difficult to deal with", although Vietnam is highly regarded as a potential place for FDI (Yamada 2004). High cost and poor quality in many infrastructure services⁸ and the lack of a sound financial system and supporting industries are also barriers to efficient investment in Vietnam. The approach for FDI attraction is also largely based on the "positive list" and target areas. The national list of investment projects calling for FDI during the period 2001-05 gives priorities in which to attract foreign investment such as mining, petroleum products and gases, energy, electronics and IT, manufacturing engineering, chemical and fertilizers, textile and

⁷ It is fair to say that various fiscal incentives and overall legal framework for foreign investors in Vietnam are on a par with practices in competing investment locations in the region (Athukurala 2004).

⁸ There has been some progress in phasing-out dual pricing for public utilities and reducing the costs of business services during 2001-04. Ministry of Finance directed Custom Office to reduce fees and time of custom administration procedure to level of the region by the end of 2003. Ministry of Finance has to cut the cost of seaport, airport, fees on animal inspection, etc. down to the level of the region by end of 2004. Ministry of Post and Communication has to cut down the cost of communication by 10-40% since April 2003. Ministry of Industry has to propose the measure to ⁸ ⁸There has been some progress in phasing-out dual pricing for public utilities and reducing the costs of business services during 2001-04. Ministry of Finance directed Custom Office to reduce fees and time of custom administration procedure to level of the region by the end of 2003. Ministry of Finance has to cut the cost of seaport, airport, fees on animal inspection, etc. down to the level of the region by end of 2004. Ministry of Post and Communication has to cut down the cost of communication by 10-40% since April 2003. Ministry of Industry has to propose the measure to down the costs for electricity loss. Also, since 2004, the measures such as the application of the same corporate tax of 28% to both domestic and foreign invested enterprises, the elimination of the supplementary income tax for domestic enterprises and the profit remittance tax for foreign invested enterprises for all enterprises regardless ownership, have become effective. Note that the corporate tax of 28% is lower than that applied for domestic firms but higher than that applied for FIEs previously.

inputs for the garments industry, construction materials and the processing of agricultural products.

III. STRUCTURAL CHANGES OF VIETNAM'S ECONOMY AND ITS REGIONAL ECONOMIC LINKAGES

Market-oriented reforms and international economic integration have brought remarkable achievements. Indeed, the economy recorded an average growth rate of 8.3% annually between 1991-96. During 1997-2000, GDP growth rate fell to 6.3% and gradually resumed its momentum in 2001-04 at about 7%. Vietnam has also entered a new phase of industrialization with its share to GDP increasing from 12.8% in 1991 to 20.8% in 2003 and 20.2% in 2004⁹. The share in total merchandise export of manufacturing export increased from 8.0% in 1991 to 43.0% in 2003 and 41.0% in 2004, while those of high-tech products increased to 3.4% in 2003 and 3.9% in 2004 from nil in the early of 1990s (Table 3).

Table 3: Some Major Economic Development Indicators, 1991-2004

Item	1991	1995	2000	2001	2002	2003	2004 ^a
GDP growth, (%)	6.0	9.5	6.8	6.9	7.1	7.2	7.6
GDP structure by ownership, (%)							
State sector	29.3	40.2	38.5	38.4	38.3	39.1	39.2
SOEs	22.2	30.3	27.7	27.3	27.2	27.2	...
Private sector	70.2	53.5	48.2	47.8	47.8	46.4	45.6
Foreign invested	0.4	6.3	13.3	13.8	13.9	14.5	15.2
GDP structure by economic sector, (%)							
Agriculture	40.5	27.2	24.5	23.2	23.0	21.8	21.4
Industry ^b	23.5	28.8	36.7	38.2	38.5	40.0	40.3
Manufacturing	12.8	15.0	18.5	19.8	20.6	20.8	20.2
Services	36.0	44.0	38.7	38.6	38.5	38.2	38.3
Export of commodities and services							
Total, (USD million)	2,492	7,293	17,144	17,707	19,606	23,060	29,370
Services	450	2,093	2,695	2,680	2,900	3160	3,470
Commodities	2,042	5,200	14,449	15,027	16,706	19,900	25,900
Manufacturing, (%)	8.0	28.4	46.1	45.0	43.1	43.0	41.0
High-tech ^c , (%)	0.0	0.0	5.4	4.0	3.0	3.4	3.9

^a Figures for 2004 are estimated

^b Including mining, manufacturing, construction and utilities

^c Electronics and computers

Source: General Statistics Office (GSO) (various issues), Central Institute for Economic Management (CIEM) (2004a and 2004b) and our calculation

The level of industrialization is often measured by the structural changes associated with the manufacturing share in GDP, the composition of manufacturing output by technology, and the shares of manufacturing export and high-tech export in total merchandise export (Weiss 2002). Table 4 shows that although Vietnam has recorded considerable achievements, at present it can be seen as an "average developing country" and is still far behind many East Asia countries in terms of industrialization.

Table 4: The Levels of Industrialization in East Asia, developing countries and Vietnam

⁹ All figures for 2004 in this report are estimated

Item	East Asia		Other developing countries		Vietnam
	1980	1997/98	1980	1997/98	2003
Manufacturing, (% GDP) ^a	31	31	20	20	20.8
Composition of manufacturing output by technology, (% share) ^b					
Low tech	58 (73)	51 (69)	78	76	74.4
Medium tech	26 (20)	29 (21)	16	19	19.9
High-tech	16 (7)	20 (10)	6	5	5.7
Manufactured exports, (% of total) ^c	45	82	23	39	43
High-tech, (% of total)	—	34	11	29	3

^a Figures for other developing countries are simple average.

^b Figures of East Asia are for Newly Industrialized Economies (NIEs) and second NIEs (in brackets); figures for Vietnam are of 2002.

^c Figures of the shares of manufacturing export in total merchandise export for other developing countries are simple average. Note that the shares accounted for by South Asia are 54% in 1980 and 78% in 1998, and by Latin America are 20% in 1980 and 49% in 1998. Figures of the exports of high-tech products are for all developing countries and simple average for East Asia.

Source: Adapted from Weiss (2002) and our calculation for the case of Vietnam

In terms of merchandise trade, East Asia is still the most important market, but with declining export and import shares. Indeed, trade with China has increased significantly, while trade with ASEAN has considerably declined. The share of Vietnam's exports to Japan has also tended to decline, while Japan is still very much an important source of Vietnam's imports (Table 5).

Table 5: Regional Export and Import Flows, 1991-2003

Country	1991	1996	2000	2001	2002	2003
Export destination, (%)						
Japan	32.9	20.7	17.8	16.7	14.6	14.3
China	0.9	4.6	10.6	9.4	9.0	8.0
Hong Kong	10.2	4.2	2.2	2.1	2.0	1.9
Korea	2.3	7.5	2.4	2.7	2.8	2.4
Taiwan	2.7	7.2	5.2	5.4	4.9	3.7
ASEAN-5	23.5	22.2	16.6	15.6	13.1	13.4
East Asia (excluding Japan)	39.6	45.6	37.0	35.2	31.7	29.4
East Asia (including Japan)	72.4	66.3	54.8	51.9	46.3	43.7
EU	5.6	13.5	21.0	20.8	19.4	19.1
North America	-	3.2	5.7	7.8	15.3	20.9
Other	22.0	17.0	18.5	19.6	19.1	16.3
Import destination, (%)						
Japan	6.4	11.3	14.7	13.5	12.7	12.0
China	0.7	3.0	9.0	9.9	10.9	12.2
Hong Kong	7.9	7.1	3.8	3.3	4.1	4.0
Korea	6.1	16.0	11.2	11.6	11.6	10.4
Taiwan	2.4	11.3	12.0	12.4	12.9	11.5
ASEAN-5	32.3	26.1	27.5	25.1	23.5	22.8
East Asia (excluding Japan)	49.4	63.5	63.5	62.4	63.0	60.9
East Asia (including Japan)	55.7	74.8	78.2	75.8	75.7	72.8
EU	12.5	11.6	9.2	10.0	10.0	10.7
North America	0.3	2.5	2.6	2.9	2.6	5.1
Other	31.5	11.1	10.0	11.3	11.7	11.4

Source: GSO and authors' own estimates

The major features of East Asian trade over the last four decades have been highlighted in many studies (see for example, Chia & Pangestu 2003, Garnaut & Song 2003, and Ng & Yeats 2003). A natural question arose is how Vietnam's regional trade engagement looks like in comparison with that of other East Asian countries?

First, East Asian economies began its growth by relying primarily on exports of labor-intensive products and gradually gained comparative advantage by shifting to increasingly capital- and technology-intensive products. At present, Vietnam's manufacturing exports are concentrated in labor-intensive products such as textile and garments, footwear, and furniture. However, primary commodities still account for a large portion of exports, making Vietnam's exports vulnerable to the volatility of the world commodity prices.

Second, East Asia saw a huge expansion of trade in intermediate goods such as machinery parts and components and rising regional intra-industry trade. Vietnam seems to be following similar patterns. Indeed, Vietnam's regional intra-industry trade index increased from 2.2 in 1985 to 19.0 in 2000, but it is much smaller than that of other East Asian economies¹⁰. Given the dualistic structure of Vietnam's economy, a large proportion of these imports are for import-substituting industries, which are dominated by the (uncompetitive) SOEs or joint ventures with the SOEs.

Third, while trade in intermediate goods is mainly within East Asia, a majority of the markets for the final products is still extra-regional. The ratio of intra-East Asian trade to regional GDP increased considerably from 1975 through to the present, but the ratio of regional exports to Europe, North America and the rest of the world rose even more rapidly. The significantly increasing role of the EU and the US as important destinations for Vietnam's exports can also be seen in the case of Vietnam. Since the Vietnam-US BTA in December 2001, Vietnam's exports to the US have increased more than four-fold over just two years, growing from USD1.05 billion in 2001 to USD4.55 billion in 2003 to about USD5.0 billion in 2004 and growth in manufacturing exports, especially in clothing exports, dominated this trend (CIEM and STAR-Vietnam 2004)¹¹.

Fourth, China has played an increasing role as trade partner, especially in intermediate goods and components in East Asia. China has also become a key trade partner of Vietnam. Although the production and merchandise trade structure between Vietnam and China are both complementary and competitive, the trade between two countries is characterized as "North-South", pointing towards the relatively low competitiveness of Vietnam's manufacturing (Vo Tri Thanh 2002). Since 2001, Vietnam's trade with China has been in deficit, which increased from USD0.2 billion in 2001 to about USD1.4 billion in 2003 and USD1.2 billion in 2004 (Yamada 2004 and CIEM 2004b).

In general, Vietnam is on a similar trade pattern experienced by other East Asian economies, but still at the early stage of regional trade engagement. While exports have been expanding to the EU and US markets, Vietnam seems unable to exploit Japan as an export

¹⁰ For Japan: 17.7 and 42.5, Korea: 48.5 and 68.7, China: 23.2 and 49.9, Hong Kong: 24.8 and 11.5, Taiwan: 48.9 and 76.5, Singapore: 44.9 and 82.3, Indonesia: 10.1 and 32.8, Malaysia: 25.6 and 65.8, Thailand: 21.3 and 61.7, Philippines: 32.3 and 56.4, respectively (Garnaut and Song 2003).

¹¹ The growth rate of exports to the US in 2004 is much more moderate than that in 2002 and 2003 as clothing exporters are imposed by quotas.

destination. Moreover, due to the relatively low competitiveness and the dualistic structure of industries (as seen in the next section), Vietnam is quite vulnerable to external shocks.

The liberalization of investments has resulted to rapid growth in FDI between 1993 and 1996. This period was the peak of Vietnam's success in drawing FDI. Total registered capital during 1988-96 accounted for 59.2% of total registered foreign invested capital flowing to Vietnam during 1988-2003 (Table 6). However, since the financial crisis in 1997, the registered FDI in Vietnam declined sharply by 49%, 16%, and 59% in 1997, 1998, and 1999, respectively. Since 2000 the situation has been slightly recovered, but it is still not sustainable despite considerable efforts of the government in improving business environment and gaining back investors' confidence. By the end of 2004, the effective FDI projects amounted to a total implemented capital of about USD27 billion.

Table 6: FDI in Vietnam, 1988-2003¹²

Item	1988-96	1997-00	2001	2002	2003	2001-03	1988-03
Number of project	1,976	1,313	550	802	752	2,104	5,393
Newly registered capital, (USD million)	26,466	12,132	2,592	1,621	1,914	6,127	44,725
Implemented capital, (USD million) ^a	10,076	10,550	2,430	2,591	2,650	7,671	28,297
Increased capital, (USD million) ^b	2,920	3,162	632	1,136	1,150	2,918	8,999
Withdrawn, (USD million)	2,689	5,550	1,437	805	1,779	4,021	12,261
Terminated, (USD million)	245	47	4	333	9	346	638

^a including Vietnam's contribution

^b by the expansion of the currently operating projects.

Source: Ministry of Planning and Investment (MPI)

Foreign invested enterprises (FIE) have now become an integrated part of Vietnam's economy. They significantly increased their share in GDP, from 0.4% in 1991 to 14.5% in 2003 and 15.2% in 2004. In 2003, they accounted for 31% of total merchandise exports and more than 36% of gross industrial output; in 2004 these figures were 33.0% and 39% respectively¹³. At present, about 650,000 workers or 1.3% of total labor force are employed by FIEs. FDI has also helped Vietnam to restructure the economy by developing new industries such as oil and gas exploration and exploitation, automotive, and electronics. It has also upgraded many other industries such as food processing, beverages, garment, and textile industries. FDI is also dominant in the production of various industrial products like office, accounting and computing machinery equipment (97.0%), radio and communications equipment and apparatuses (81.4%), and motor vehicles (80.5%), among others. (Dinh Van An et al 2003).

Foreign investors from East Asia are primal among the 64 countries and territories, which have investments in Vietnam. Indeed, the top five investors, namely Singapore, Taiwan, Japan, Korea, Hong Kong are from the region. During 1988-2003, East Asia accounted for 75.7% projects and about 70% committed capital and implemented capital (Table 7).

¹² During the first 11 months of 2004, 630 new FDI projects with the total capital commitment of USD 1984 million were licensed. Those figures are respectively 1.6% and 28.0% higher than that during the same period of 2003 (CIEM 2004b).

¹³ The figures for the share of exports by FDI sector do not take into account the crude oil export, which is dominated by Vietso Petro Corporation, a joint venture between Vietnam and Russian. Otherwise, these figures increased to 51.0% in 2003 and 54.1% in 2004 (CIEM 2000b).

Table 7: The Accumulated FDI in Vietnam, by Country and Region, 1988-2003

Ranking	Country	No. of Projects	Committed Capital		Implemented Capital	
			Total (USD)	Share	Total (USD)	Share
1	Singapore	289	7,814,442,954	18.7	3,034,110,337	12.1
9	Thailand	117	1,392,717,492	3.3	1,934,803,849	7.7
12	Malaysia	135	1,134,563,423	2.7	778,168,568	3.1
22	Philippines	20	224,623,899	0.5	83,470,734	0.3
23	Indonesia	11	120,052,000	0.3	126,671,322	0.5
46	Laos	4	11,053,528	0.0	5,478,527	0.0
50	Brunei	4	6,000,000	0.0	-	-
59	Cambodia	2	700,000	0.0	400,000	0.0
	ASEAN	582	10,704,153,296	25.7	5,963,103,337	23.9
3	Japan	426	4,595,172,471	11.0	3,968,689,521	15.9
4	Korea	671	4,252,231,004	10.2	2,722,601,172	10.9
2	Taiwan	1096	6,217,758,439	14.9	2,640,728,675	10.6
5	Hong Kong	290	2,984,967,736	7.2	1,805,520,602	7.2
15	China	249	521,791,802	1.3	146,777,521	0.6
	East Asia	3314	29,276,074,748	70.2	17,247,420,828	69.0
	EU	603	9,185,525,196	22.0	5,939,912,169	23.8
11	US	181	1,163,582,430	2.8%	709,083,792	2.8
	North America	215	1,233,332,476	3.0	726,087,451	2.9
	Total	4380	41,707,553,019	100.0%	24,992,422,868	100.00%

Figures only for effective projects.

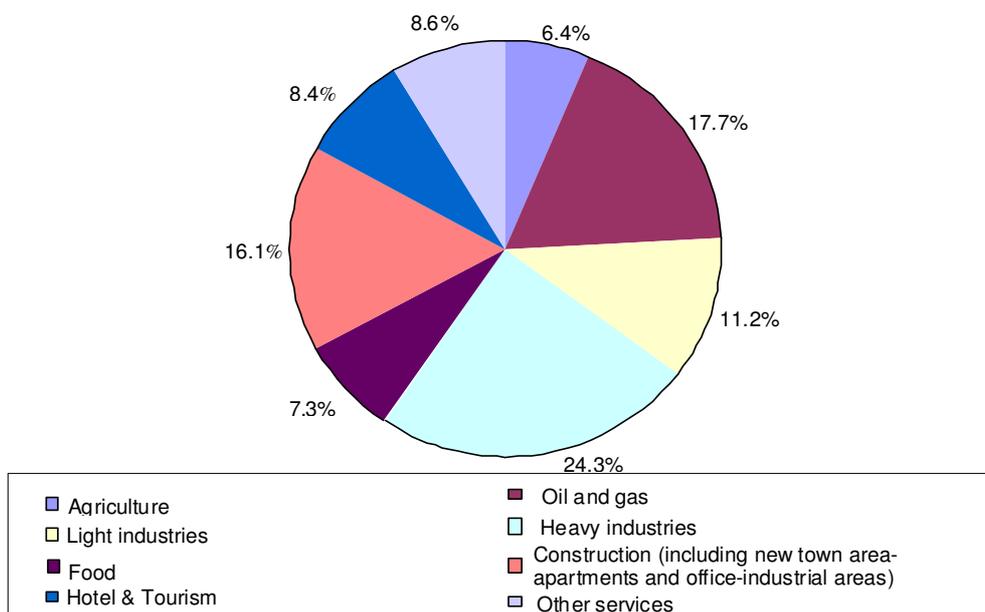
Source: MPI and our calculation

However, since 1998, FDI from the region, especially that from Japan, has declined considerably. During 1998-2003, the registered FDI from Japan was only USD516 million. In 2003, FDI from Japan was even smaller than that from China (about USD100 million in comparison with USD138 million) (Yamada 2004). 2004 saw some improvement in attracting FDI in general and from the East Asian countries in particular, including Japan¹⁴.

FDI inflows in the 1990s concentrated on large-scale projects in real estate and import substitution industries, in which Vietnam does not hold comparative advantage. Since around the end of 1990s, there has been a tendency towards the export manufacturing sector and the FIEs have accounted for much of the recent manufactured export expansion. For instance, the share of FIEs in total manufacturing exports increased from 20% in the early 1990s to over 70% by the early 2000s (Athukorala 2004). Recent reports also pointed out that recently approved FDI projects by Japanese companies have been mainly engaged in export-oriented processing (Fujita 2003). The FDI coming into high value added services sectors, however, still are limited (Figure 1).

Figure 1: Implemented FDI by Sector, 1988-2003

¹⁴ During the first 11 months of 2004, 52 Japan's FDI projects with the total capital commitment of USD 200.8 million were licensed by Vietnamese authorities.



Source: Authors' calculation based on data provided by the MPI

It is increasingly evident that the spillover effects of FDI in the host country in terms of technology and know-how transfer, market expansion, workforce skills improvement, and competition promotion, are essential for sustainable growth and long-term development. These effects of FDI in Vietnam, however, are still not significant as expected and this is more or less reflected in Vietnam's industrial competitiveness.

IV. VIETNAM'S INDUSTRIAL COMPETITIVENESS

The competitiveness of Vietnam's economy has been recognized as rather low. The World Economic Forum (WEF) has ranked the (growth) competitiveness of Vietnam's economy, though improving, at the lower end on the list, positioned 39/53, 48/53, 53/59, 60/75, 65/80, and 60/102, and 77/104 for the year 1998, 1999, 2000, 2001, 2002, 2003, and 2004 respectively¹⁵. In 2003, compared to other ASEAN economies, Vietnam was considered more competitive than Indonesia and Philippines, but much less than Singapore, Malaysia, and Thailand (CIEM 2003a). In the report of the government to the 11th National Assembly Congress at the end of 2003, Prime Minister Phan Van Khai stressed that Vietnam's competitiveness has not been improved significantly during the past and therefore, the improvement of its competitiveness must be a focal task of Vietnam in the coming years.

The concept of competitiveness by the WEF is largely associated with the prospect of medium- and long-term per capita growth, which in turn is determined by three major factors, namely economic innovation, the macroeconomic environment, and openness. This section examines Vietnam's industrial competitiveness from various perspectives. First, the industrial competitiveness can be measured by the international competitive coefficient (ICC) index, which is defined as net exports over total trade, $X - M / (X + M)$ ¹⁶. Second, it can be revealed in the

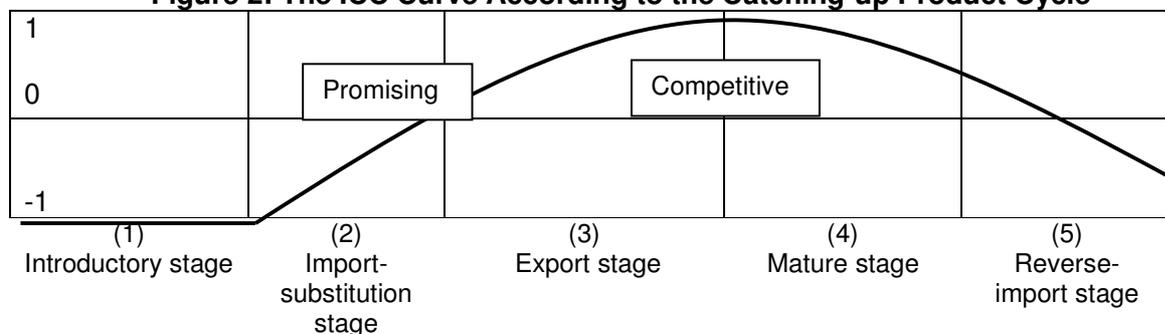
¹⁵ In 2003 Vietnam ranked at the 56 among 80 economies under consideration in 2002.

¹⁶ The revealed comparative advantage (RCA) index is widely used for measuring industrial competitiveness. But, according to Hiratsuka (2003, this index is not a suitable index since it measures

economic structure as a “natural” outcome of the industrial policy and trade regime. Third, the analysis of the cost and quality advantages at different points in the value/supply chains can also be used for the assessment of firm’s/industry’s weaknesses/strengths.

The ICC index takes the form of values between minus 1 and plus 1. As the ICC index is rising, competitiveness is increasing. The ICC index also reflects implicitly the demand and supply sides and hence, it can trace the catching up process with regard to the different stages of product lifecycle. The ICC curve in Figure 2 is very much related to the classical paradigm of “flying geese pattern”, in which the forerunner flies in front of the following groups, with the latest starters bringing up the rear of the formation. Apparel and home electrical appliances are typical industries following the “flying geese pattern” in East Asia. However, in the context of globalization and shortened product lifecycle, the flying geese pattern in some industries can be partly collapsed in that the latecomers could proceed to the more advanced competitive stage. For example, in precision apparatus, Thailand and China moved up to the “export stage” and Korea still stayed in the “import substitution stage.”

Figure 2: The ICC Curve According to the Catching-up Product Cycle



Source: Hiratsuka (2003)

Based on the ICC index, Hiratsuka (2003) has summarized the position of industrial competitiveness for the East Asian economies. For Vietnam, the agricultural and processed agricultural products and light industries (such as apparel, footwear, furniture and miscellaneous manufacturing) are competitive. Promising industries include home electrical appliances, office, communication and precision apparatuses, and some supporting industries (such as metal processing, home electrical appliance parts, electronics and industrial machinery), though they have yet not developed. Heavy machinery industries in general are not competitive.

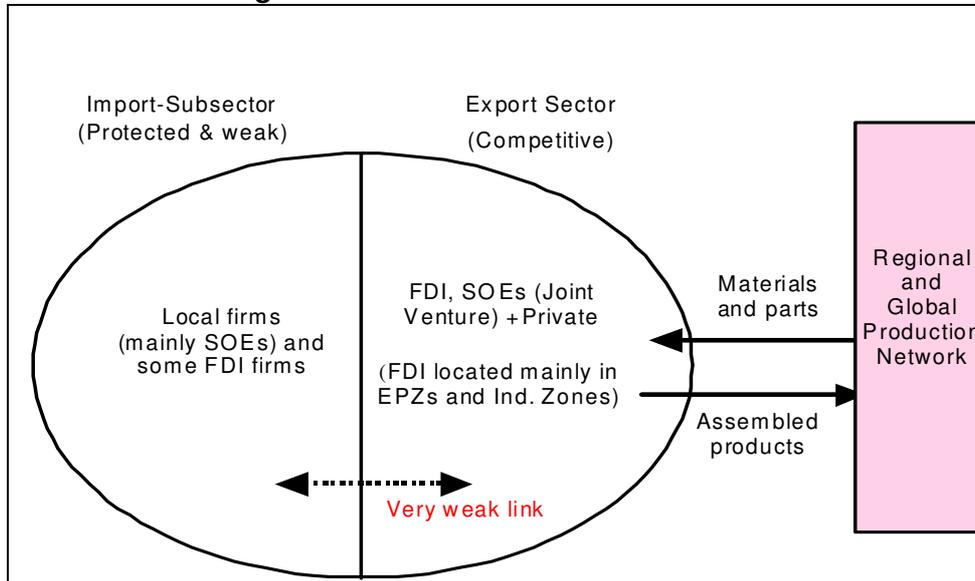
In general, this assessment is consistent with the study by CIEM (2003a), which has shown that Vietnam has mainly the (static) competitive advantages in natural resources-based and labor-intensive industries. According to Tran Van Tho (2004), Vietnam would have comparative advantage in simply- and medium-skilled labor-intensive industries, agricultural raw material, and labor-intensive industries in the medium-term.

A salient characteristic of Vietnam’s present manufacturing structure is its dualism, which has been substantially created by the industrial and trade policies Vietnam pursued for a long time. On the one hand, export manufacturing firms, especially the FIEs and some domestic private firms, form part of the sectors that are globally competitive. On the other hand, the

the *relative* degree of export specialization in comparison with world levels regarding specific commodities, but many industries in East Asia have enhanced their competitiveness at the same time.

import-substituting firms, especially the SOEs and some FIEs, are weak and protected (Figure 3).

Figure 3: Vietnam's Industrial Dualism



Source: Ohno (2003) and National Economic University (NEU)/ Japan International Cooperation Agency (JICA) (2003) with our modifications

Some distinguishing features of Vietnam's industrial dualism are worth noting. First, the role of private firms in industrial development, while surging during the last four years, is still small. Indeed, the share of private firms in total GDP, manufacturing output and total employment is only about less than 4%, 6% and 3% respectively (World Bank 2002). Internationally competitive private manufacturing firms are rare.

Second, there is a weak linkage between foreign firms and local firms and between upstream and downstream industries. In many industries such as garments, footwear, electronics, automobiles, and motorbikes, almost all of the raw materials and immediate inputs were imported. Recently, many studies and surveys showed a common result that supporting industries are both lacking and poorly developed in Vietnam. Survey results from 64 foreign-invested enterprises in food processing, garments, and electronics industries by the German Development Institute found that the level of local procurement of raw materials and semi-manufactured inputs from FDI was very limited, except in the food processing industry and packaging materials¹⁷. Many other supporting industries, which serve the newly developed industries in Vietnam, are at a very primary step such as the molding industry. According to a survey by the Japan Overseas Development Corporation among 23 Japanese firms in Vietnam, only 2 companies source between 50 to 65 percent of their inputs and materials from Vietnamese firms, the utilization of the rest of the companies is under 35%¹⁸. About half of those surveyed assessed that Vietnamese precision machinery were not of acceptable quality, about and the rest mentioned that they could not locate the suppliers or that the prices were quite high. Vietnam now can supply only the low and medium technology-supporting industries such as steel consumption components, carton packages, etc.

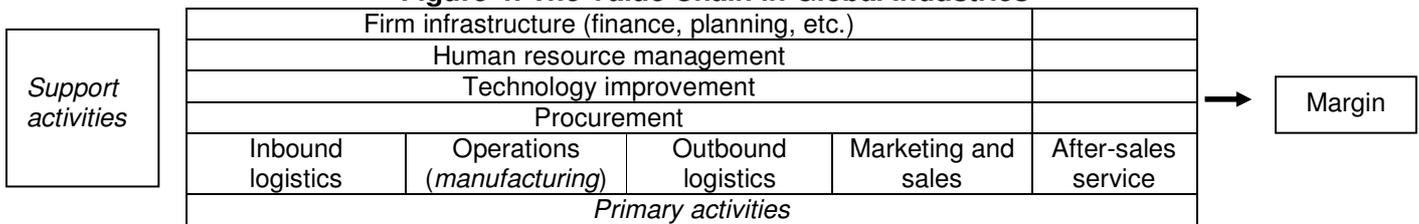
¹⁷ Cited in Fujita (2003)

¹⁸ *Saigon Economic Times*, 27 March 2003

Third, the weak linkage between foreign firms and local firms has also limited FDI spillovers. Knowledge-intensive activities such as R&D carried out through FDI in Vietnam are very limited. Most Vietnamese workers are employed for simple assembly activities. Despite the increasing contribution of FDI to Vietnam's exports, newly increased export-oriented FDI projects in recent years generally have limited backward linkages with local firms and create limited spillover effects on the local economy (Fujita 2003).

The relatively low competitiveness of Vietnam's manufacturing is also reflected in global and regional value chains. Sustained competitive advantage requires firms to build on their current strengths and to develop others; they need to have not only the cost advantages (low wage and access to low cost local raw materials) but also the quality advantages (brand name, technology specific to a firm). But it does not mean that firms need to do everything themselves and there are three possible routes for de-verticalization or "splicing-up" the value chain (Weiss 2002). One is based on a lead firm-supplier relationship. The second involves a less formal set of links between lead firm and suppliers based on geographical proximity and close relationship (the network of regional clusters). The third involves a more commercial relation between the lead firm and its suppliers.

Figure 4: The Value Chain in Global Industries



Source: Weiss (2002)

Local firms in Vietnam, in general, are recognized as weak in both support activities (management, human resource, technology) and primary activities, especially those associated with cost-effective linkages. As subcontractors and assemblers, they have tended to become marginalized at the lower/lowest end of the production supply chain.

In the case of producer-driven chains, multinational corporations (MNCs) have market power in capital and technology-intensive sectors (such as automotive and motorbike industries in Vietnam) and therefore, they control the whole production system based around a set of backward and forward linkages. The dominant MNC establishes relations with its suppliers either through direct ownership or subcontracting. As in many developing countries, Vietnam has often used tax incentives as rewards/penalties to push localization, with the hope that these measures can promote the development of supporting industries. But the outcome was more disappointed than successful (see the case study of automotive industry in Appendix).

In the case of buyer-driven chains, which can be found in labor-intensive sectors such as in garments, footwear, and consumer electronics, the large international retailers, branded marketers and trading companies set up a series of assembled production networks, typically in low wage locations. Production is normally carried out by local firms that make final goods according to guidelines provided by transnational buyers and profits are determined less by production volume, but more by design, marketing, sales and financial services. Vietnam has been facing with two problems. First, as alternative low wage locations can be found, international production with buyer-driven chains becomes increasingly competitive and this puts continual downward pressure on wage. The second is how Vietnam can efficiently have a

continual upgrading of export composition with higher value added. While attempting to develop (capital-intensive) upstream industries (often through public investment), Vietnam has paid not enough attention at the role of services in the value chains (see the case study of textile and garment industry in Appendix).

Without a closer link between high value added services and manufacturing, it is difficult to move steadily up the value chain of production. Despite considerable progress in cutting down “the cost of doing business”¹⁹, especially the costs of telecommunications, the costs and efficiency of key services sectors have still relatively penalized firms operating in Vietnam (Table 8).

Table 8: Business Operating Costs in Vietnam and Other East Asian Countries, 2003

City	Office rent (USD/month/ m ²)	3 minute call to Japan	% change (2002-2003)	Electricity (US¢/Kwh)	40 feet container to Yokohama (USD)
Hanoi	24.0	2.7	-54%	5-7	1,300
Ho Chi Minh	21.0	2.7	-54%	5-7	900
Manila	4.5-7.2	1.2	0%	9	850-1,100
Beijing	43.0	2.9	0%	5-7	500
Jakarta	14.0-20.0	4.0	5%	5	890-990
Bangkok	11.0	2.3	8%	5-7	1,200
Kuala Lumpur	9.92-17.7	1.4	1%	5	575

Source: Japan External Trade Organization (JETRO) (2004)

On the one hand, the key infrastructure sectors are being opened up and partially liberalized. This policy is an attempt not only to deal with the problems of monopolistic/oligopolistic structures in some key services sectors (which are dominated by the SOEs) more effectively, but also to reach a mutually acceptable compromise with trade partners (during the process of negotiation for accessing to WTO). On the other hand, Vietnam does not underestimate the crucial need to maintain a certain degree of strategic control on the development of core services industries (such as energy, telecommunication, marine and air transport) (Gabriele 2004) in the long run.

In sum, Vietnam’s industrial dualism and weaknesses in both support and primary activities in value chains would have a negative impact on the economy in the long-run. The harmful impact of this industrial structure is to reduce national/enterprise competitiveness and, to increase the vulnerability of the economy to external shocks during the process of trade liberalization and international integration.

VI. POLICY OPTION ALTERNATIVES

Vietnam has recorded remarkable socio-economic achievements during the process of market-oriented reforms and international economic integration. However, in terms of industrialization, Vietnam only rates averagely among developing countries. In general, Vietnam seems to be on a similar track of regional economic engagement experienced by other East Asian economies at their earlier stages of development. There are, however, some worrisome

¹⁹ During 1998-2002, the office rent (USD/month/m²) reduced by 1%, the three minutes call to Japan (USD) by 72%, the power cost (cent/kwh) by 20%, and the 40 feet container to Yokohama (USD) by 20% (cited from Gabriele 2004).

concerns about competition from China as “the largest manufacturing factory” in East Asia, and the vastly underutilized potential FDI inflow from Japan. Moreover, due to the industrial dualism and several weak points in value chains, Vietnam has relatively low competitiveness and is quite vulnerable to external shocks. It is no doubt that Vietnam has comparative advantages in several labor-intensive and resource-based industries but the question is how can Vietnam take full advantage of labor while moving up value chain for higher value added. Indeed, Vietnam has the potential of falling into the so-called “low cost labor trap”, which will not be in the economy’s best long-term interest (Vo Tri Thanh 2002). Our analysis suggests that in order to improve overall competitiveness and to join the regional production network effectively as an important driving force of industrialization, Vietnam needs to change its way of thinking, its trade and investment policies, and do away with its industrial dualism.

A. Change in the way of thinking

Being an economy in transition, Vietnam’s approach to development strategy and industrial and trade policies in various aspects are still rooted in a legacy of a centrally planned economy; they are reflected in the ways of directing and controlling the resource/capital allocation, reforming the SOE sector, and manipulating trade and industrial policies (import-substitution and export promotion). While Vietnam can learn a lot from the experiences of East Asian countries in the past, it would have great difficulty in making a Korean- or Japanese-style industrial policy work efficiently even if the rules of the international economic system allowed such actions. First, the structure of Vietnam’s economy is different from that of their neighbors at a comparable stage of development. Second, Vietnam does not have the political and social underpinning of an efficient industrial policy that eschews politics and corruption (Perkins 2001). In fact, the timeframe for policy changes is being narrowed as Vietnam is approaching the deadline for the implementation of its international obligations in the context of its WTO accession and the formation of the regional FTAs.

It is not exaggerated in saying that Vietnam’s reform process is now being an international commitment-based reform process. The first and foremost is to change the present state-led and state-controlled institutions into business-friendly and efficiency-enhancing institutions.

B. Changes in trade and investment policies

Trade policy towards the protection of import-substituting industries through high ERPs and NTBs could make serious distortions in investment structures and resource allocation. The protectionist policy also has a negative impact on the economy in the long-run, reducing both national and firm competitiveness and increasing the vulnerability of the economy to external shocks. In the coming years, with the NTBs expected to be removed, further tariff reductions and substantial uniformity with regard to its structure will be an effective way for Vietnam to reduce and eliminate the anti-export bias (Athukorala 2004).

An appropriate strategy would be for Vietnam to take advantage of the pressure brought about by international integration to accelerate the process of restructuring SOEs and the banking system and to combine between changes in investment rules and fundamental economic reform (Fujita 2003).

The international experience has shown that a liberal and neutral environment is better than promoting heavy financial incentives for attracting efficient FDI. In that sense, improvement of overall competitiveness is very essential. Given Vietnam’s commitment to international economic integration, the government has pointed out three main groups of measures for

strengthening competitiveness: (i) institutional improvement, consisting of developing an open, transparent and predictable legal system and its enforcement, and the improvement of the public administration system; (ii) economic structural reform, consisting of financial and SOE reforms, etc; and (iii) improvement of investment environment and cutting down of the business costs.

Over the medium- and longer-term, it is without a doubt that public investment will still play an important role in economic development. But one question is how to make the best use of such investment. In our opinion, public expenditure should be re-directed to focus on areas that will create positive externalities for business activities such as infrastructure and information provision. To deal with existing problems in the industrial structure, some fiscal incentives can be used but they should be selective. Another question is how reliant economic development is on non-state investments. The key step is to create a 'level playing field' and to improve the business environment for attracting FDI and promoting development of local private firms. The increasing participation of foreign and private firms in public projects is also essential for reducing the burden to state investments.

C. Dealing with industrial dualism and weak linkages in value chains

How to have a cost-effective linkage between upstream and downstream industries and develop supporting industries in several industries has recently been a "hot" question in discussions among policymakers and researchers in Vietnam.

In some long-term industrial development strategies, the government seems to emphasize the development of upstream industries through public investment. However, those industries are often very capital-intensive, where Vietnam does not have advantage. Unless these industries could gain international competitiveness in terms of cost, the investment would hardly be efficient. Most of the troubled industries of Vietnam in the last four or five years are related to high cost and import-substituting industries. An alternative way is to take full advantage of labor cost together with human resource development and FDI attraction in order to gradually have dynamic advantage gains. Development of industries would be then more market-led rather than government-led.

The weak position of supporting industries is due to several reasons. First, the supporting industries are mainly in the hand of the SOEs that have outdated technologies, and therefore their products are of high-priced with low quality. Second, firms in these industries have low profits due to the lack of economies of scale. Third, the private sector still does not have enough capital and interest in investing in several supporting industries. Fourth, for FIEs, high transaction costs, thin markets and low profitability compared to other investment options have impeded them from investing in supporting industries (Dinh Van An et al 2003). The government attempted to use various measures to force foreign investors to develop supporting industries such as local content requirements and tax incentives but there have been no evidence thus far that points towards the success of these policy measures (Athukorala 2004). Some policy makers also want to establish supporting industries even before the export sector grows but this seems unrealistic (NEU/JICA 2003).

In fact, developing supporting industries is very much relating to the development of the private sector and SMEs. In addition, the development of SMEs must go hand in hand with the development of human resources as well as the creation of a level playing field and an enabling business environment for all economic entities. FDI can play an important role in developing supporting industries through the promotion of joint ventures between (private) domestic SMEs

and foreign partners in supporting industries. There is a need then for the government to offer incentives. In this context, official development assistance may be linked with human resource development and the enhancement of the partnership between Vietnam's and foreign SMEs in developing supporting industries. Also, Vietnam should avoid doing everything and focus on the sectors wherein Vietnam would have comparative advantages and benefits in the long-term socio-economic development (Dinh Van An et al. 2003).

In order to move up the value chain of production, it is very crucial to establish a closer link between higher value added services and manufacturing. This in turn depends on political will since many services sectors are very closely associated with interest groups. It is also essential to have a stronger consensus among policymakers as to how services will be liberalized (i.e., the sequencing and speed). Furthermore, the government needs to have measures to deal effectively with the distortions in market structure by strengthening competition and eliminating market failures. Opening some key services sectors for foreign participation is also an effective measure for getting more benefits of FDI spillovers, which are now still limited.

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APPENDIX 1: CASE STUDY OF THE TEXTILES AND GARMENTS INDUSTRY

The establishment of Nam Dinh textile factory in Red River Delta, North of Vietnam in the late 19th century is regarded as the starting point for the development of the textile and garment (T&G) industry in Vietnam. Over time, the T&G industry has experienced a lot of ups and downs, especially during the 1970s and 1980s. Since 1990, the reforms and international integration has revived the T&G industry and placed the industry into a new stage of development. The average annual growth rate of T&G industry was high at 10.4%. In 2003, the garment export accounted for 18.4% of total export value, nearly twice larger than that in the 1994 (10.6%) (see also Table A1). By the year of 2000, there were 800 domestic private, joint stock and limited liabilities enterprises and 178 joint-venture and 100% foreign-owned enterprises in the T&G industry. The state sector, which has 187 textile and garment enterprises, still dominates the T&G industry, although its importance has relatively reduced in recent years as both domestic private and foreign firms continuously grew up. By the end of 2003, the T&G industry created 1,600,000 jobs, accounting for about 25% of total industrial labor force (Bui Quang Tuan 2004). In general, development of Vietnam's T&G industry is regarded as impressive but not outstanding.

Table A1: Major Indicators of T&G Industry
(VND billion at 1994 price, otherwise indicated)

Item	1995	1999	2000	2001	2002	2003
Total industrial output	103,374.7	168,749.4	198,326.1	227,342.4	261,092.4	302,990.1
Total export, (USD million)	5,448.9	11,541.4	14,483.0	15,029.0	16,705.8	19,900.0
Textiles	6,176.2	8,388.4	10,046.3	10,641.3	12,337.8	14,223.5
Growth, (%)	3.2	0.3	19.8	5.9	15.9	15.3
Garment	2,949.8	5,217.6	6,042.3	6,861.7	8,181.9	9,892.1
Growth, (%)	15.3	18.8	15.8	13.6	19.2	20.9
Export of T&G (USD million)	850.0	1,746.2	1,891.9	1,975.4	2,752.0	3,630.0
Growth, (%)	—	16.0	8.3	4.4	39.3	31.9

The growth rates of T&G exports in 2002 and 2003 are largely explained by the sharp increase in the export to the US market (thanks to the implementation of VN-US BTA)

Source: GSO (various issues)

I. Industry characteristics

Although the growth rate of the T&G industry was rather high, the asymmetrical growth within the industry has been large. For example, during 1996-2003, the growth rate of garment production was much higher than that of textile production (Table A1). The unbalanced growth of the industry had caused a strong dependence on textile imports for local consumption as well as production.

The government made considerable efforts to upgrade technology in the textile sector, but in general this sector could not provide textiles with quality meeting the demand of garment sector. Moreover, the textile sector has also suffered from the lack of locally-grown/produced raw materials. Vietnam's textile sector has had to import 90% of cotton and 100% of yarn for annual production.

In the meantime, the technology of the garments sector has been generally upgraded, although this sector has got much fewer supports from the government. Many garment enterprises are now capable of making rapid production adjustments in response to the market needs thanks to the installation of new technology and IT-enhanced equipment. However, the technology upgrade in the garments sector seems does not seem to be enough to lift the sector

onto the higher ladder of value chain. Therefore, this sector has mostly focused on the production of unsophisticated and quota-required products such as shirt, jacket, coats, home dressing and the like, while either some categories with granted quotas or some markets without quota but high quality requirements are still neglected.

The upstream linkage between the textiles and the garments sectors has been low, leading to a heavy dependence on imported raw inputs for production. Currently, imported inputs have made up to 50% of total inputs for the garment sector. In 2003, for the T&G industry as a whole, the total import value of raw materials amounted to more than USD4 billion, while the total export value was USD3.6 billion.

Vietnam's garments enterprises are now still struggling to establish "trademarks/brands" for themselves, leading to a heavy dependence on intermediary firms located in Hong Kong, Taiwan and South Korea. Currently, about 70% of the total export value of the garment sector has been via those intermediaries. This implies that the low value added due to low technology and heavy dependence on imported inputs has been further exacerbated as a proportion of this value added had to be transferred to the intermediaries.

The export of garments has also been concentrated in some quota-required markets such as the US (accounting for 54% of total garment export value in 2003), the EU market (16%); the export value to Japan and Taiwan, two non-quota markets, accounted for only 19% of the total garment export value. Although more and more enterprises have shifted a part of their production chain to serve the local market, which is viewed as large with a total annual market value of around USD2.8 billion, the local demand for high-end products was still satisfied by foreign producers.

Like many other Vietnamese industries, the T&G industry has also suffered from inefficiency. The utilization capacity rate of the industry is fairly low. In 1997, the utilization rates in the textiles and the garments sectors were 75% and 81% respectively. Moreover, the industry has been vulnerable to external shocks such as the financial crisis in 1997-98, reflected by its negative growth rate in 1998 (-3.5%) and the disappointed export growth rates in three consecutive years of 2000-01 (Table A1).

Productivity at the firm level is rather diverse, depending on the ownership and the size and the location of the firms. According to a study by the IOE (2002), domestic private firms outperformed the SOEs and FIEs in terms of technical efficiency and technical progress during 1997-2000, despite their low starting base. In the meantime, the SOEs lost their leading position and the FIEs showed a mixed picture in terms of technical efficiency. Regarding the size of firms, smaller firms achieved a higher level of technical efficiency during hard times, while larger ones took the leading position during times without abrupt changes. Firms located in the central region seen to have lower technical efficiency compared to their rivals in the northern and southern regions, that shared the similar technical efficiency.

It is worth noting that the major characteristics/problems of the T&G industry are recognized by the managers of the companies in the industry. More importantly, it is increasingly understood that both government and firms should be more responsible for the task of improving the national and firms' competitiveness (Box A1).

II. Challenges ahead

It is expected that the T&G industry would be severely hit as all barriers for T&G products would be lifted for WTO members by 1 January 2005, causing possibility of unlimited supplies of garment and textile products from developing countries to developed countries. The study by Ianchovichina et al (2002) has shown that China's WTO accession would lead to a substantial decline in Vietnam's apparel exports and production (the most significant decline is expected to occur around 2005 when quotas on Chinese apparel are removed). Moreover, it is expected to put a downward pressure on unskilled wages in third countries including Vietnam, which may increase inequality. According to a member of Vietnam's T&G Union, even if Vietnam becomes a WTO member, the T&G industry will be confronting fierce competition in terms of prices, tougher requirements on environment, technology, and social policies (e.g., overtime work), legal obedience, and controlling systems on trademarks²⁰. Nearly all interviewees have recognized China as the most serious competitor in T&G. Surprisingly, however, they said their companies can survive or compete with Chinese firms.

The most serious concern is about government policies. While pointing out some shortcomings of particular policies/laws, the interviewees would like the government to have more predictable and consistent policies. In addition, simplifying and making administrative procedures transparent are considered to be key factors for ensuring business efficiency (Box A1).

Many scholars called for the termination of the deep involvement of the government and the Vietnam Textile and Garment Corporation (VINATEX) in the production and business process. Instead, they should be facilitators for the development of the industry through provision of information, development of physical infrastructure, and institutional support. The role of VINATEX should be realigned to become an agency providing services such as training, designing, testing and research to both the SOEs and private firms.

It is worth mentioning that the government master plan for the development of the T&G has the objectives of increasing value added by shifting production modality from CMT to FOB²¹ and by raising the domestic content of garment exports by actively investing in the cotton, spinning and weaving industries.

However, it has been argued that the ratio of FOB contractual arrangements to total production, or the "FOB ratio", does not correctly reflect the magnitude of value added or the content ratio of domestic input materials. The shift from CMT to FOB, therefore, does not necessarily guarantee increased value added and competitiveness. Given its own competitive advantages, productivity of CMT is still low by international standards primarily due to inadequate management practices. Therefore instead of focusing on the shift from CMT production to FOB, Vietnam should pay more attention to improving management skills in product development, upgrading production and distribution channels, training adequate human resources to carry out product design and development process, and, expanding to the domestic market (NEU/JICA 2003).

Relating to the development of upstream industries, through active investment by the state, many scholars keep their skeptical views on this strategy due to the likely decline in the demand for domestic textiles once import duties are reduced in 2006. By that time, the upstream industry may face with difficulties. If the country insists on developing the upstream

²⁰ This is response by a member of the T&G Union to the authors' interviews

²¹ CMT refers to a production modality where Vietnam's firms are provided all input materials from foreign buyers, whereas under the FOB production modality, they are purchased by Vietnamese firms

industry, it should be limited to areas leading to enhanced quality and customer confidence. However, enhancing competitiveness of upstream industry through selective investment is not enough for increasing the content ratio. Opportunities for and facilitators of production linkage should also be established and enhanced.

Box A1: Responses by the CEOs of T&G Companies to the Authors' Interviews

A. Hanoi Garment Company No. 40

- Company profile: Hanoi SOE established in 1960; Employees: 1457; Income/employee/month: VND850,000; Assets: VND33,480 million; Turnover: VND31,646 million; Profit: VND27 million; Contribution to the state budget: VND 203 million; Main products: jackets, skiing clothes(All figures are for 2003).
- Nearly 100% of the products are exported (those sold in the domestic market are saved ones). In 2003, of total sales 37.5% were by FOB and 62.5% by CMT. All input materials are imported from abroad by foreign buyers, except for a small proportion of materials/spare parts, auxiliary package, bought domestically. In both cases, the created added values are low.
- Competition is very high. In fact, the company has had to use Internet for market research and contracts with partners from the U.S., Canada, South Korea, Taiwan and Japan. China now seems to be more competitive since it has cheap labor and does not depend on imported materials. In the mean time, China has been improving ability to design and to diversify products.
- The company, however, is quite optimistic about its competitiveness. The company has had more than 40 years of experience and credence to customers. More importantly, the company has been "very proactive and dynamic in doing business."
- Of much more concern are government policies. The Law of Labor has a tendency of having regulations in favor of laborers only. Employers have had to pay social insurance for employees without reaching the required productivity, and the stipulation of working hours including fixed and over-time working hours, is not sound. Vietnam's import duty policy is not beneficial to producers. For example, one foreign company hires a local firm to do the processing with a material loss rate of 8%, while the local firm is permitted to have a much lower loss rate for tax calculation. As a result, the local firm has to pay import duties for the rate difference, causing the foreign company to lower their loss rates of materials. Many government policies are not practical; everyone has the right to resolve enterprises' problems but no one has to bear the responsibility for mistakes or wrong decisions. Last but not least, the government policies are often changeable and inconsistent.

B. Hanoi 19/5 Textile Company

- Company profile: Hanoi SOE established in 1959; Employees: 680; Income/employee/month: VND900,000; Assets: VND93,553 million; Turnover: VND85,126 million; Profit: VND5,222 million; Contribution to the state budget: VND3,172 million; Products: canvas and garments (All figures are for 2003).
- Canvas accounts for nearly 90% of the company's turnover. Local firms now account for 40% of the domestic canvas market (of which 38% belong to the company). Regarding the garment products, all styles and models are designed by foreigners and then the duties of cutting and sewing are carried out by the company. Since 2000, garment production value has increased at the average annual growth rate of 30%.

- The company formed the joint ventures with foreign company (Hanoi 19/5 textile company and Norfolk joint venture textile and garment company) with a view to learn management skills, to attract technology, and to have more customers.
- There are some government policy-related problems that reduce the competitiveness of Vietnamese firms: First, government policies, particularly land policy, are often changeable (price of using land for production now doubles, which causes production cost to rise). Second, high costs of such inputs as electricity, water, telecommunication (all are governed by some monopolistic SOEs) have a negative impact on production. Third, the cooperation among firms/enterprises in the same industry is still loose. Fourth, administrative reforms are being slowly undertaken. Fifth, workers in general have to be trained on the spot before taking up jobs. Sixth, capital is firms' difficult issue but procedures of borrowing money are cumbersome and as a result, firms lose business opportunities.

C. Mua Dong Knitwear Company

- Company profile: Hanoi SOE (1960: a partnership; 1983: Mua Dong Knitwear Factory; 1993: Mua Dong Knitwear Company); Employees: 955. Income/employee/month: VND749,000; Assets: VND14,852 million; Turnover: VND39,462 million; Profit: VND373 million; Contribution to the state budget: VND665 million; Main products: sweaters, socks, acrylic yarn (All figures are for 2003)
- 71% of the company's turnover is accounted for by export, in which 65% is by FOB for the European markets and 35% is by CMT mainly with the buyers from Taiwan and South Korea. At present, up to 90% of materials and machines have been imported.
- A hard issue of the company is to offer customers with competitive price. Private enterprises are able to accept all kinds of payment while the company, as a SOE, must use bank accounts for payments if they want to enjoy VAT of 0% for exports. There is also problem of quota distribution by the Ministry of Trade. When the company wants to export CAT 5 products, it must have quota distributed by the Ministry of Trade. However, there have been times when the company got contracts but failed to meet them because the quota was not distributed to the company.
- When Vietnam joins the WTO, the company will face more fierce competition from many countries, especially from China. Chinese firms have several advantages. They can make their own materials, manufacture their machines, and have lower labor cost but higher productivity. The advantages of the company are that it has loyal customers, skilled workers and good quality products. However, the company should invest a substantial capital on modern technology such as spinning machines, high-pressure dyeing machines (made in Italy and Japan) if it wants to meet the needs of customers. The company should also pay more attention on domestic market. It intends to increase the turnover share of domestic market from 29% to 50% in the near future.
- Some government policies are not promoting export. As regulated by law, materials imported for export production are not paid import duties. However, the company has to pay import tax first, which will be refunded later. This somewhat complicated procedure has had negative effects on the company's production since its production is seasonal and therefore, the availability of current capital is very essential. Moreover, profitability of the company could be reduced significantly if it has to borrow substantial money from banks with high interest rate. There is also a

lack of government support for the exporting companies (such as in terms of land hiring).

APPENDIX 2: CASE STUDY OF THE ELECTRONICS INDUSTRY

The electronics industry is increasingly becoming a hub for diffusing innovation to other activities. This industry is obviously an engine of industrialization and modernization. Recognizing the importance of this industry in the development process, since the middle of 1980s, some electronics enterprises have been established to lay the very first stones for the development of Vietnam's electronics industry. However, the development of this industry could only be seen in the 1990s when some foreign investors established their firms in Vietnam. Compared to other industries, the electronics industry was relatively small, but its contribution to the total industry output has been increasing from 3.8% in 1996 to 6.6% in 2000, of which the FIEs had contributed 4.4%. The export turnover of this industry also increased over time, from USD266 million in 1996 to around USD766 million in 2000 (Pham Thai Hung 2003). The FIEs have played a key role in exporting electronics. According to the Ministry of Industry, there are nearly 150 enterprises involved in this industry, of which 67 enterprises specialize in production of components. The SOEs, though, have played a minor role in this industry. Of the 67 enterprises specializing in electronics components, there are only 5 local enterprises; the remaining firms are FIEs (including 100% foreign-owned enterprises). Currently, Vietnam's electronics production is still focused on home appliance products such as television sets, radio cassette recorders, DVD players, washing machines and air-conditioners (see also Table A2).

Table A2: Major Indicators of Electronics Productions
[Growth (in %) in parentheses]

Item	1995	1999	2000	2001	2002	2003
Total industrial output	103,374.7	168,749.4	198,326.1	227,342.4	261,092.4	302,990.1
Total exports, (USD million)	5,448.9	11,541.4	14,483.0	15,029.0	16,705.8	19,900.0
Office, accounting and computing machinery	27.9 (41.6)	1,702.7 (746.8)	1,295.2 (-23.9)	976.7 (-24.6)	1,002.9 (2.7)	1,144.1 (14.1)
Radio, TV and communication equipment	2,064.8 (49.1)	3,993.4 (14.8)	4,395.3 (10.1)	5,407.0 (23.0)	6,168.6 (14.1)	7,433.1 (20.5)
Export of electronics, (USD million)	— (—)	553 (—)	766 (38.5)	608 (-20.6)	492 (-19.1)	672 (36.6)

Source: GSO (various issues)

I. Industry characteristics

The electronics industry of Vietnam is dominated by assembling, which is the lowest value added stage of the production chain. Previously, electronics firms carried out franchise contracts with foreign firms to assemble products and sell it later in the local market (UNIDO/DSI 1999). This kind of contract lasted until foreign firms entered the market. In order to survive, local firms had to switch either to assembling well-known brands or introduce products bearing their own brands. Most of these locally-branded products, however, were either designed abroad or bought from well-known firms; even the production lines were also equipped and organized by foreign firms. Recently, some state firms have aimed to move into original equipment manufacturing and original design manufacturing rather than assembly-type manufacturing, but efforts made to develop such designs at this stage seemed to be wasted since it was not easy for them to gain consumer confidence especially.

The electronics industry could be categorized into four sub-industries, including (1) consumer electronics or home appliances, (2) industrial electronics (including components and

related materials), (3) communications equipment and (4) hardware for the IT industry. In 1998, consumer electronics dominated the electronics industry, comprising about 40% of total production value while communications equipment constituted about a third of output. Computers represented about 15% of output and industrial electronics accounted for about 13% (UNIDO/DSI 1999). Over the past several years, there has been little change in this pattern of production. While the production of Vietnamese enterprises could satisfy 75-80% demand for home appliances, a large share of demand for industrial electronics was met by imports; value from producing hardware for IT industry and communication equipment has still come from assembly-type production (Vietnam Economy Online, various issues).

The underdevelopment of this industry is also represented by the low local content ratio of products in the category of home appliances, those are considered as less sophisticated in the electronics industry. By the year 2002, the local content ratio was only 60-70% for “normal” TV set, 30-35% for “flat” TV set and 15% for “super flat” TV set. The local content ratio also was about 30-50% for other products (Pham Bac Hung 2003).

The electronics industry is typically capital-intensive, but it turns out that in Vietnam, it is labor-intensive. This is because of the limited capacity to expand into higher-end stages in the production chain. Except for some firms that have deep pockets that specialize in component production for export to other countries such as Fujitsu, the investment in local firms was low. In 2002, the total investment of the SOEs in this industry was around USD38 million, accounting for only 4-5% of total investment in the whole sector. On the other hand, local private firms invested 18-22% of the total investment.

The Vietnamese electronics industry also lacks competitiveness in many aspects. This is reflected by the fact that there has been virtually no exports from local firms since 1993; only limited exports have taken place through joint ventures firms and fully-owned foreign companies. These companies can be categorized into two groups: firms that export home appliances (most of which are television sets), and those with a clear-cut export-oriented strategy. Firms from the latter category have viewed the country as a production base for its affiliates in other countries. However, their number is still very small. Indeed, Vietnam, unlike several of its neighboring countries, does not export semiconductors, telecommunications equipment, office machines, and other consumer electronics products (Vietnam Economy Online, Various issues).

II. Challenges ahead

Given the following conditions whereby (1) Vietnam’s advantage lies in cheap labor and a highly-qualified labor pool, (2) that the world’s leading electronics companies have already establishing their assembly facilities in other countries in the region, and (3) that there is a tiny market for electronics products domestically, Vietnam should select the best strategy, which will enable it to catch up with other countries in the region. Simultaneous development of the entire industry at the moment seems to be so ambitious; this means that Vietnam should focus on the production of the parts and components in which it has advantages and so as to efficiently develop the market.

The government’s current policies such as local content requirements may hinder the entry of foreign firms. In this case, the relatively small amount of assemblers in the country is proving to be a disincentive to the entry of electronics producers. The lack of producers means a lack of attractive prospects for assemblers, thereby causing a vicious cycle. Two measures may be used to break this cycle: (1) Vietnam should produce spare and component parts by itself; (2) Vietnam should remove policies hindering the entry of foreign investors (NEU/JICA).

The first measure seems to be artificial as only a few domestic component producers are capable of meeting the foreign companies' requirements in terms of quality and price. The second measure is more practical in some aspects as removing currently existing hindrances would attract more investors to Vietnam. Second, it will avoid the flood of finished products from other ASEAN countries as the tariffs for finished products will be significantly reduced when Vietnam fully implements its AFTA commitments.

The electronics industry is a capital-intensive business, which needs economies of scale in order to make a profit and local assemblers have failed to work together in creating economies of scale. The situation will only improve if priority is given to assemblers working in cooperation.

The story of the Hanel Electronics Corporation has shown that despite its own efforts to improve competitiveness of the corporation, the government is unlikely to have a clear-cut understanding of the multi-dimensions of electronics industry and a sound strategy for development of this industry (Box A2).

Box A2: Response by a CEO of Hanel Electronics Corporation to the Authors' Interview

- Company profile: Hanoi SOE established in 1984; Employees: 428; Income/employee/month: VND1.3 million; Assets: VND88,2051 million; Turnover: VND196,398 million. (2003)
- The definition of the electronics industry is still controversial; however, it can be understood as an industry that produces: electronics, telecommunications equipment; electronic components and materials; computer software, embedded software used for appliances; and electronic services.
- Despite being a company specializing in electronic production, HEC is focused on research, and its operations are limited to assembling parts and components. In reality, domestic products for electronics are listed as packaging, printing materials, capacitors, loudspeakers, and the rest or 80% of its electronic products are imported. It is attributed to the fact that basic research is the starting point, skilled labor is insufficient, investment on R&D is lacking, and government support is minimal. In addition, HEC's capital for R&D is trivial, at about VND10 billion /year.
- In the meantime, Vietnam and HEC, together with other ASEAN nations are in fear of Chinese electronic products. Therefore, it is vital that HEC as well as Vietnam's electronic industry should have a development strategy. HEC has the intention to invest in either some national focal projects or embedded technology, and electronic chips. In addition, its aim is also at producing components and parts. Human training is also of interest as it is aware that the industry requires highly-skilled labor. Part of its strategy is to cooperate with some multinational corporations in electronics. HEC also recommends that the government should have more transparent and liberal policies and provide full support for electronics' development.

APPENDIX 3: CASE STUDY OF THE AUTOMOTIVE INDUSTRY

It was in 1951 when the first automotive factory was opened in Hanoi, marking the establishment of Vietnam's automotive industry. Forty years later, the oldest automotive factory in the country formed a joint venture called Vietnam Motor Corporation (VMC) with some foreign trading firms to assemble cars under the brand of Kia (Korea), Mazda (Japan), BMW (Germany)

and Subaru (Japan). The second joint venture, Mekong Corporation, was established a year later to make cars with kits supplied by Mitsubishi (Japan) and Fiat (Italy) (UNIDO/DSI 1999). There are now in 11 foreign-invested automotive firms in Vietnam, seven of which are Japanese, and there are also a number of local companies without their own brands or under local brands. In 2003 the industry employed around 10,000 people²².

I. Industry characteristics

The first outstanding feature of the automotive industry in Vietnam is that there are too many world-class automakers in a tiny market. By the middle of the 1990s, a bulk of well-known carmakers rushed to Vietnam and although all automotive factories are small-scale, car production was still always far below the factories' respective design capacities. Production peaked in 2003 at 30,000 cars but this is only 20% of the designed capacity. This figure is only 1/360 that of Japan, 1/16 that of Malaysia and 1/15 that of Thailand. Car sales, however, has been increasing rapidly in recent years. Indeed, the growth rate of car sales was 200% in 2000, 140% in 2001, and 137% in 2002.

The government has regarded the automotive industry as one of the most important industries that would lift the country onto industrialization and modernization. Therefore, the government has provided this industry with many incentives to boost its development. According to the Law on Special Consumption Tax, automobiles of 24 seats and under are subject to tax rates of varying between 30% and 100%. While all imported cars are subject to import and special consumption taxes, locally assembled cars have enjoyed a special consumption tax reduction of up to 95% and pay only between 1.5% and 5% and are not subject to import tax. Moreover, the State also protects local assemblers by banning the import of four-seat sedans. Agencies and organizations allowed to purchase cars with the State funds have been required to buy locally assembled cars. Under such government's protection, the automotive industry has become one of the most profitable industries in the country.

Together with incentives, the government has also asked automotive makers to commit themselves to reaching the goal of increasing the ratio of local components to total components to 30% after ten years of operation. This has also become a key requirement before an investment license is granted. At present, this ratio is still very low. Toyota Vietnam has reached the highest ratio but only at 10%, while the ratio of some assemblers is just 4% of total components. Producers have blamed the low demand for cars for this situation.

Poor utilization, high protection and the low use of local components have all placed a heavy burden on consumers. Automotive industries, like many other heavy, capital-intensive industries, could be profitable under the mass-scale production. However, by the end of 2003, it was observed that automotive firms in Vietnam have been making handsome profits in spite of low utilization rates. It has been presupposed that these profits did not come from mass production but from consumers. According to Ministry of Finance, prices of locally assembled cars were much higher compared than those of regional countries. Take the retail-selling price of the Fiat Siena, a passenger car assembled by Mekong Auto. As with other imported cars, a Fiat Siena had to bear an import duty of up to 60% of its original price plus a 160% special consumption tax. Although enjoying 0% value added tax, these two taxes alone have raised the retail-selling price of imported cars to 220% of their initial price. In the meantime, although total

²² The data used in this section provided by Vietnam Automobile Manufacturers Association and quoted in Vietnam Economy Online, various issues (<http://www.vneconomy.com.vn/eng>); otherwise indicated.

taxes that a locally assembled Siena had to bear are around 40%, the retail-selling price is still 206% of the original price (Vietnam Economy Online, 26/5/2003).

The automotive industry has been subject to the government's over-ambition without considering the local economic conditions. Indeed, even though the country lacked domestic components producers whose products could meet the requirements of the foreign investors, the government had issued 11 licenses to foreign investors to build small-scale automotive factories in Vietnam. Given the small market size, only two such factories operating at full utilization could have satisfied market demand. This is an example of how the government's ignored initial conditions in a rush to develop the industry. Furthermore, enormous protections were given to those producers with the hope that the profit-seeking producers could help fully develop the country's automotive industry. In reality, those policies did not produce the targeted results and have pushed car prices high. Since then, the government has now reviewed its vision with regard to the automotive industry to 2020. Foreign investors are viewing the government's vision as impossible.

II. Challenges ahead

In August 2003, the Ministry of Industry drafted the "Master Plan for Automotive Industry Development." The main targets of the plan are: i) enough supply for the domestic market and ii) development of export competitiveness. Its outlines are: i) the establishment of 20 SOEs and (ii) the achievement of high use of local components. The Prime Minister's decision and the Ministry of Science and Technology (MOST) circular have also stipulated a minimum local content ratio for passenger vehicles of 20-25% by 2005 and 40-45% by 2010 (Table A3).

In the meantime, the MOST has been considering the adoption of a so-called "point system" to calculate a formula for localization ratios. Import of parts and components for CKD1 (low localization assembly) categories will not be permitted after 2004 according to the Prime Minister (April 2003). In order to protect the automotive industry, a CBU of less than 15 seats is now included in the GEL within the Vietnamese CEPT list. Control schemes for import licenses of CBU and local procurement requirements from domestic KD automotive companies were abolished in January 2003. Furthermore, instead of depending on well-known automotive makers, three Vietnamese corporations have been identified as the main engines for the development of the industry, including the Viet Nam Automobile Industry Corporation, the Viet Nam National Coal Corporation, and the Viet Nam Engine and Agricultural Machinery Corporation. These three corporations have been tasked to make components for cars and trucks from spare parts.

Table A3: Some Targeted Indicators in 2001-2010 Strategy of Automotive Industry
(in percent)

Item	Target by 2005		Target by 2010	
	Meeting the domestic demand	Local content	Meeting the domestic demand	Local content
General automobile	40-50	40	>80	60
Specific automobile	30	40	60	60
Tourism automobile, high quality bus and truck in JVs		20-25	80	40-45
		20		35-40

Source: CIEM (2003b)

The government have argued for those changes in its policy towards the automotive industries that

- (i) In the last few years, foreign investors have failed to carry out their commitments to develop the industry. After ten years of operation, the number of spare parts and components producers that were investing were very limited;
- (ii) Foreign investors, instead of fostering the development of the industry, have made best use of the government's protection to get bit profits;
- (iii) Trends have shown that Vietnam would not have an automotive industry after it fully implements the provisions of AFTA and joins the WTO if the local content ratio will not reach 20% by 2005.

However, many scholars, both Vietnamese and foreign, as well as the foreign investors have responded that:

- (i) Developing the automotive industry requires time and ten years is not enough given the low level of per capital income in Vietnam. Furthermore, this industry is increasingly needing deep pockets as well as highly qualified human resource, which are both lacking in Vietnam;
- (ii) The local market was still so small that it is not profitable to invest in producing spare parts and components. As long as the total sales was less than 200,000 units per year, spare parts and components producers could not find a reason to invest.
- (iii) Given integration trends, Vietnam should not try to develop the industry by itself. Vietnam is different from China, where the market is very much bigger. Instead of developing an entire industry, Vietnam should specialize in those areas wherein it has a competitive advantage.
- (iv) In addition to developing the industry, conditions for its sustainability should be focused, of which motorization, is the most important. Motorization requires improvements of infrastructure system, petrol distribution, vehicle sales, and local government apparatuses to support the use of motor vehicles in Vietnam and thus the growth of the domestic automotive industry (UNIDO/DSI 1999).

The managers of both automotive FIEs have negative responses to government policies and of policy implementation. Up to now, the automotive FIEs and policymakers could not reach a consensus. Moreover, their future business plans do not seem to be in favor of what is expected by the government, making the Master Plan more difficult to fulfill (Box A3).

Box A3: Responses by the CEOs of the Automotive Companies to the Authors' Interviews

A. Vietnam Motors Corporation

- Company profile: Joint venture company licensed in 1991 between Columbia Motors Group (Philippines), VinaMotor and Nichimen Corporation (Japan); Total investment: USD58 million (Legal capital USD18 million); Employees: 592; Income/employee/month: VND2 million; Assets: VND618,116 million; Equity: VND355,834 million; Turnover: VND1,656,818 million; Pre-tax profit: VND274,950 million; Contribution to the state budget: VND342,672 million; Production capacity: 4,000 vehicles/year. The company specializes in assembling and producing all types of motors for domestic consumption and export and in related services (All figures are for 2003)
- The company's products have been mainly for domestic consumption rather than export and therefore its operation depends very much on the government's policies and domestic demand. At present, demand is not high and the quality of

infrastructure is not good. In the time being, the automobile industry is enjoying preferential import duties but the company will find it harder to sell its products when tariffs are eliminated.

B. Hino Motors Vietnam Limited

- Company profile: Established in 1996; Investment capital: USD17,030,700 (legal capital USD8,111,000); Shareholders: 1. Automobile Repairing Factory No. 1 (33%), 2. Hino Motors Ltd. (31%), 3. Sumitomo Corporation (16%); Income/employee/month: VND3.4 million; Assest: VND88,076 million; Equity: VND81,918 million; Turnover: VND77,127 million; Profit: VND5,620 million; Contribution to the State budget: VND7,769 million. The business is the assembly and manufacture medium and heavy tricks, and passenger cars under the Hino labels. (All figures are for 2003)
- The most concerning issue is the competition from old vehicles that the government has allowed to be imported. This has been especially the case of 20- to 24-ton trucks. As old trucks can now imported, the FL and FM model vehicles assembled by Hino Motors Vietnam Ltd. are not demanded as much.
- The second is competition is with new vehicles. The low import duties (10%) for the new 20- to 24-ton trucks have also resulted in fierce competition of the FL and FM model trucks domestically made by Hino with the new vehicles made from South Korea, Russia and China that are imported massively.
- The third is competition with chassis buses. Again, the import policy allowing South Korean and Brazilian buses to be imported does not encourage these vehicles to be assembled domestically, though the bodies of Hino's chassis buses are assembled by Vietnamese agents. In fact, the CKD import duty levied on chassis buses made by Hino is 10% while that of new vehicles is 20% and there is no import restriction.
- In the next few years when tariff barriers will be removed, the company would find it difficult to compete well in the market; as a result, it has the intention to provide some other services.