

Vietnam's Industrialization Strategy in the Age of Globalization

Key Issues and Policy Advice

NEU-JICA Joint Research Project, 2000-03



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GRIPS

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About NEU-JICA (ODA Project)

- In-depth studies of individual industries for concreteness and policy relevance
- Advising Vietnam's policy makers
- Link to Japan's FDI & ODA policies
- Books, webs, discussion papers...

<http://www.neujica.org.vn>

<http://www.grips.ac.jp/module/vietnam>

<http://www.grips.ac.jp/vietnam/VNIPs>



View of the Japanese Team

“Vietnam has the potential to soar in East Asia and FDI is the key; but growth may stall if FDI policy does not improve *dramatically*.”

This view is also shared by:

- JP-VN Investment Agreement (Nov. 2003)
- JP-VN Joint Initiative (Phuc-Hattori, Dec. 2003)
- Japan's revised ODA Strategy for VN (2003)
- JP-VN Investment Working Group (monthly)

Cross-cutting issues

- Vertical vs. horizontal orientation
- FDI dynamics & role of policy
- Critical mass of FDI -- not yet reached
- Localization debate
- Designing tariff reduction
- Industrial parks



Vertical vs. Horizontal Orientation

- **State-led view** (Some Vietnamese)

State should guide and direct the market; otherwise, growth will be too slow or imbalanced. Invest in upstream industries.

- **FDI-led view** (Japan team; some Vietnamese)

FDI is key for competitiveness; policy should support investors and follow global market dynamics. Help local firms link with FDI networks.

Industry A
textile

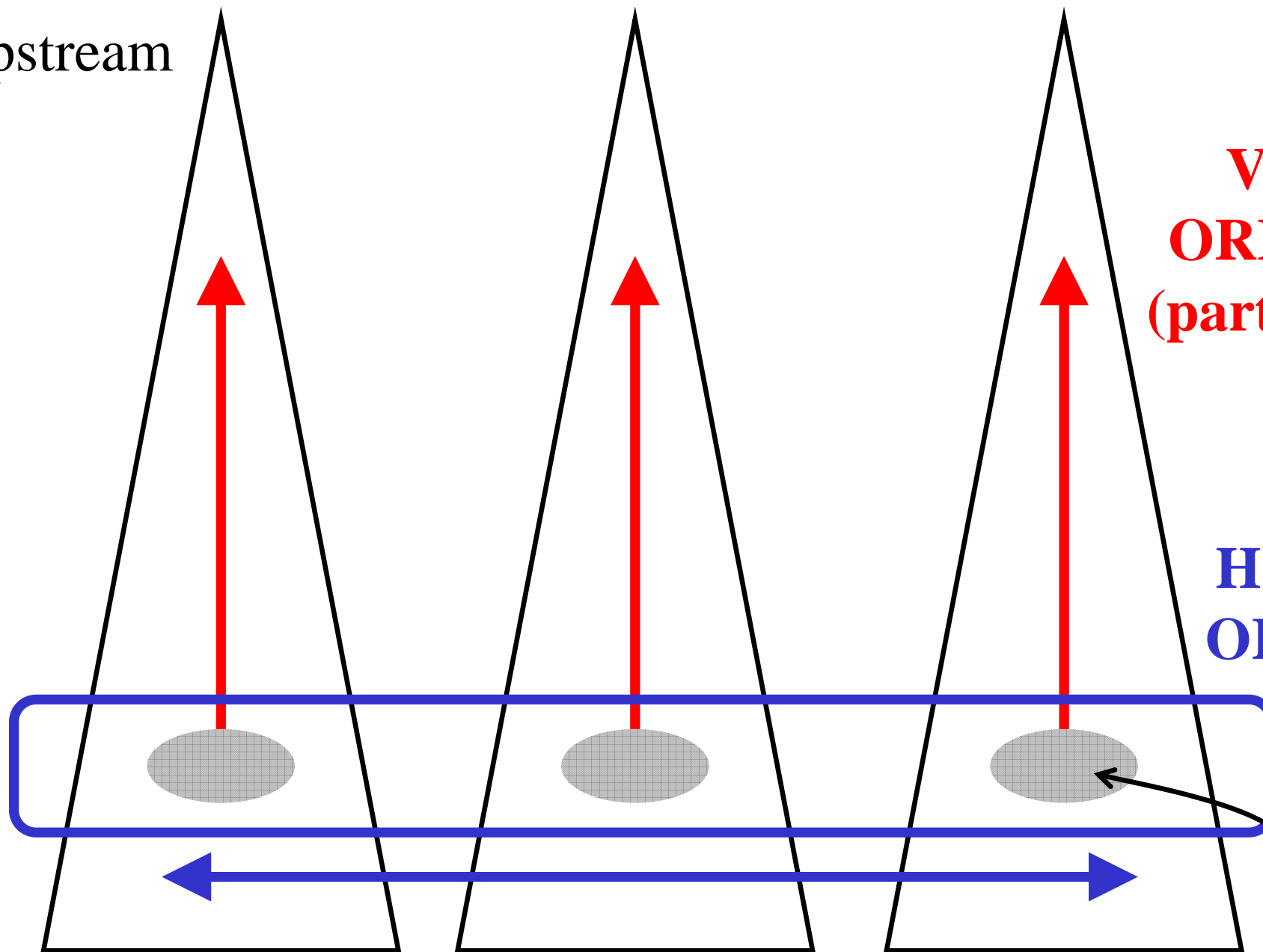
Industry B
electronics

Industry C
motorbike

Upstream

**VERTICAL
ORIENTATION**
(parts & materials)

**HORIZONTAL
ORIENTATION**
(assembly)



Current size

Downstream

Comparison #1

	State-led View	FDI-led View
Who should lead?	State should guide market; growth is imbalanced or too slow without it	Absorb critical mass of FDI with open & low-cost business climate
Localiza- tion policy	Use reward/penalty to speed up local supply of inputs	Encourage natural & demand-led localiza- tion (don't force it)
Upstream sector (materials & inputs)	State must invest upstream if FDI or private firms don't do it	Don't invest unless globally competitive; vertical integration shouldn't be aimed

	State-led View	FDI-led View
Import-subst. industries	State must support and protect it if necessary; job & industrial concern	Let market decide under tariff reduction; but help firms with realistic plans
Export industries (garment, electronics...)	Little contribution to VN's economy due to low local value-added	Very important; encourage them with open & low-cost FDI climate
Trade liberalization	Inevitable, but national interest must be considered in the process	Choose appropriate speed to encourage efficiency & avoid social crisis



FDI Dynamics in East Asia

“Vietnam is trying to reduce costs and improve systems: why does FDI remain stagnant? What is wrong with current policy effort???”

OUR ANSWER:

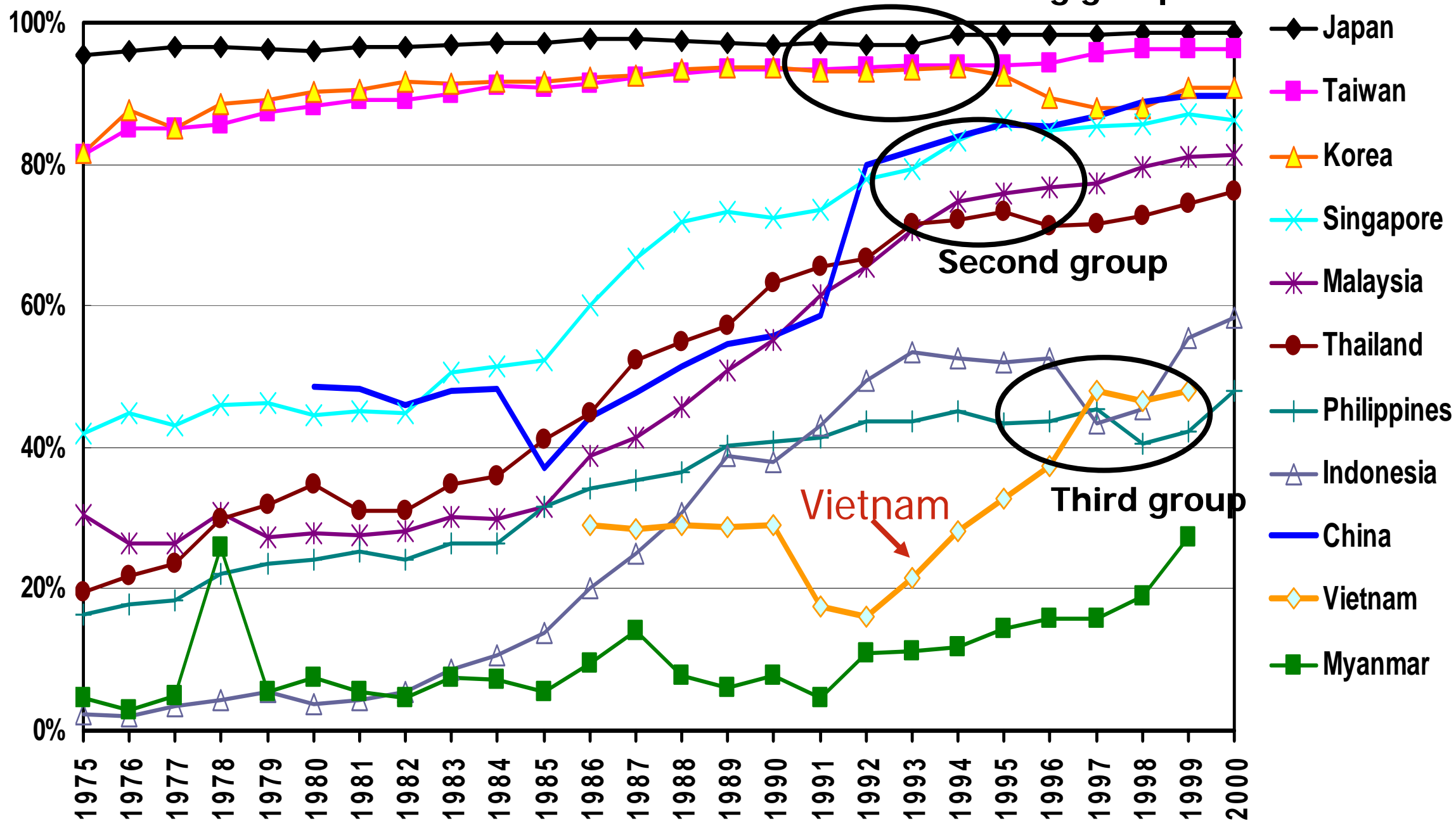
- Gradual improvement is not enough to change investors’ bad perception of Vietnam.
- China is rising faster; VN remains *relatively* unattractive compared with China (and others).
- Critically important: dramatic policy change coupled with vigorous FDI marketing.



Photo by Saizou Uchida (location: Sakai-gun, Fukui Prefecture, Japan)

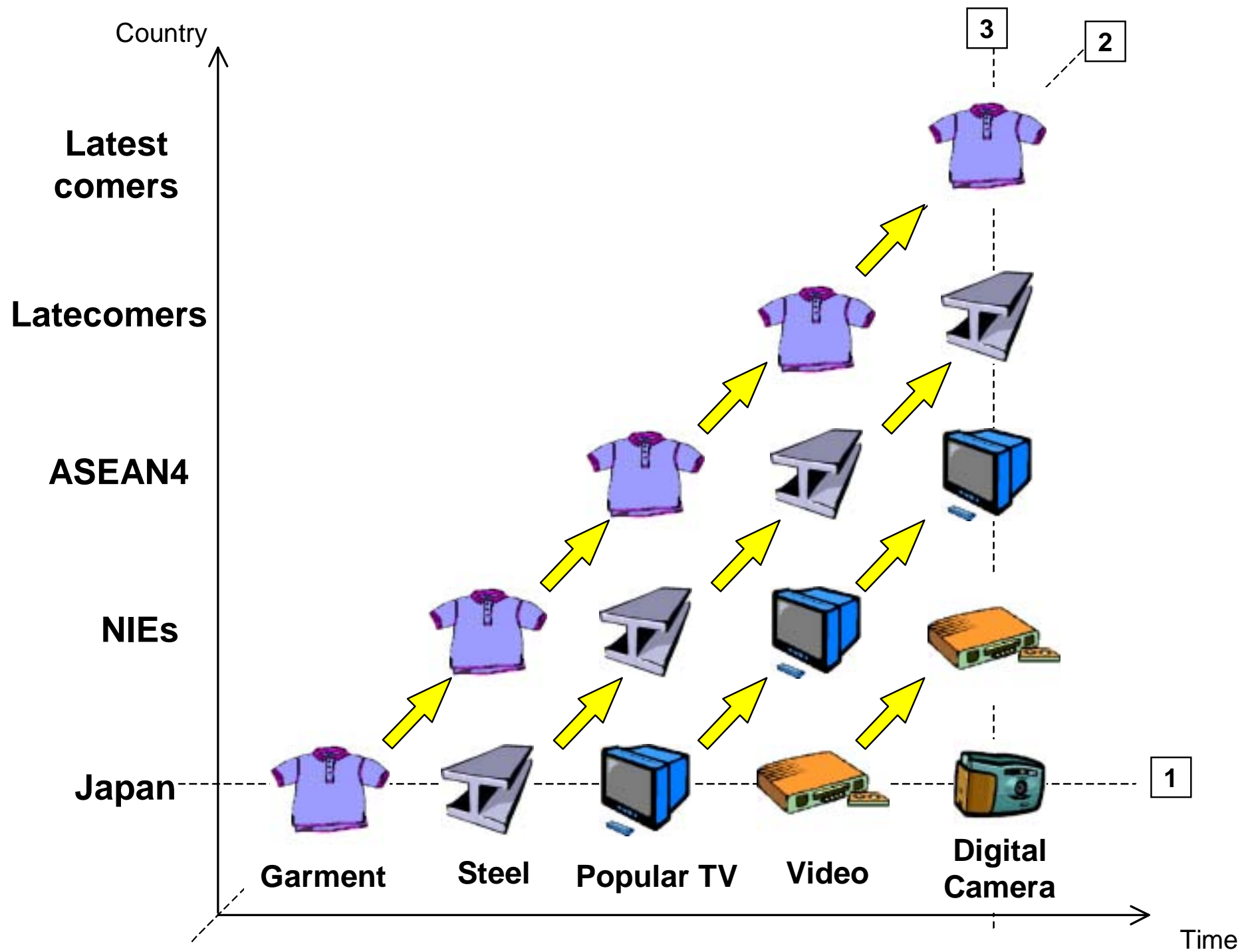
Manufactured Exports

(% of total exports)



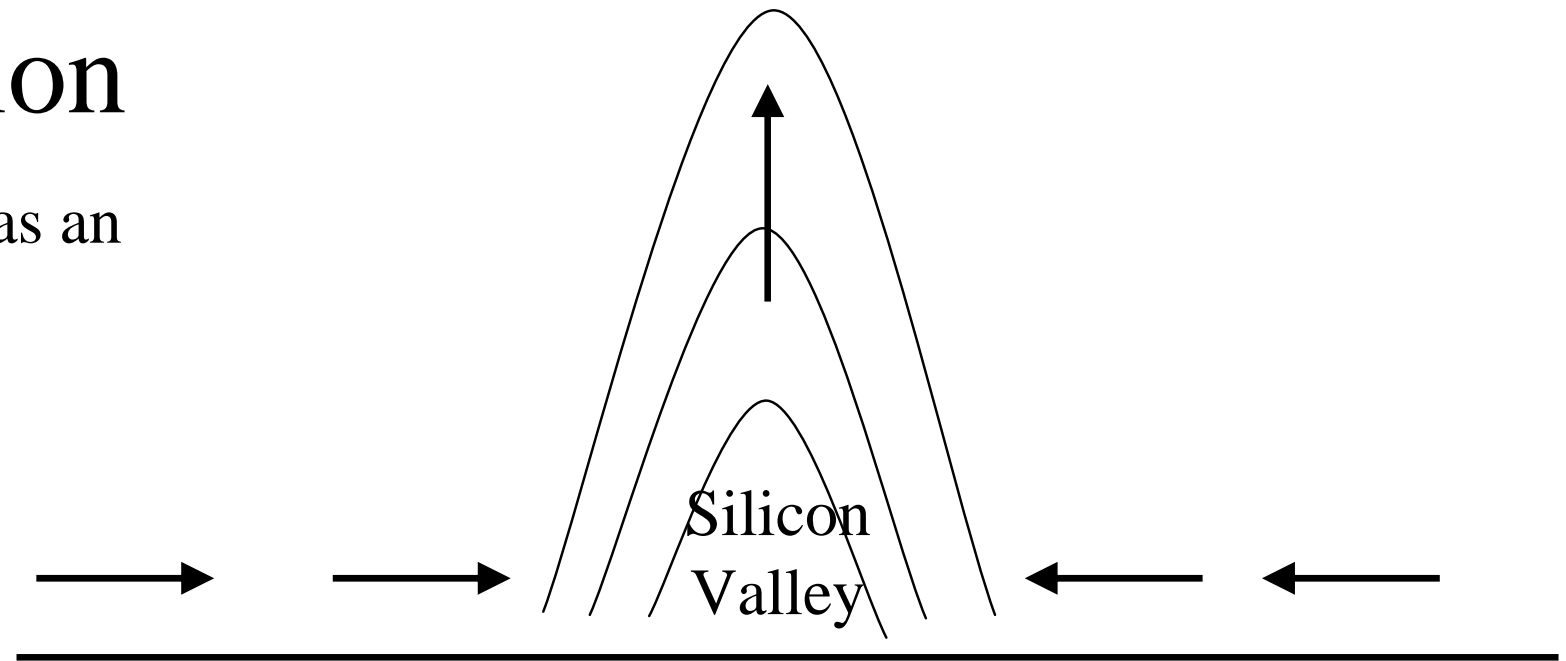
Source: ADB, *Key Indicators of Developing Asian and Pacific Countries*, 2001/1993; IMF, *International Financial Statistics Yearbook 1990*. For Japan, *Japan Statistical Yearbook 2002/1999*, Statistics Bureau/Statistical Research and Training Institute, Ministry of Public Management, Home Affairs, Posts and Telecommunications, Japan.

Structural Transformation in East Asia



Agglomeration

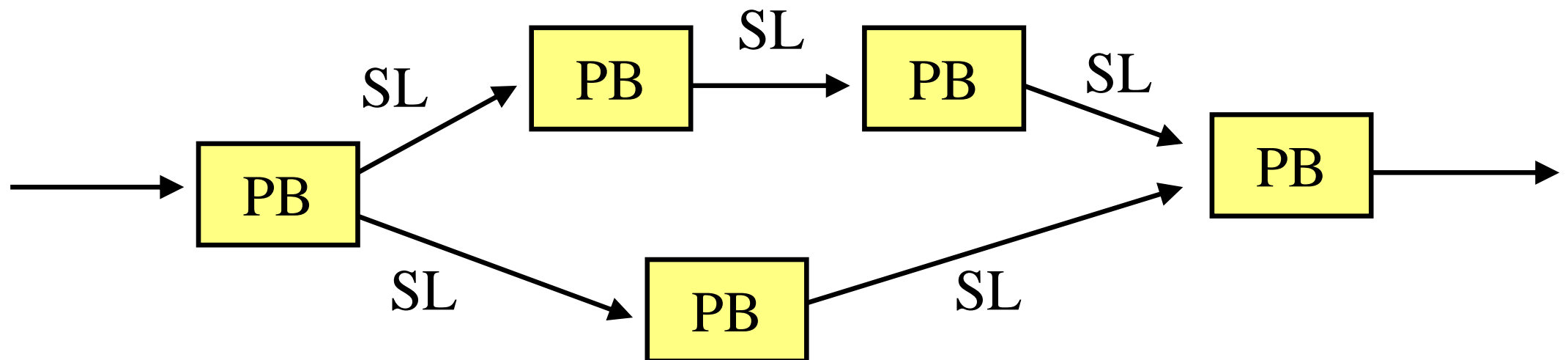
Initial concentration has an accelerating effect



Fragmentation

International division of labor in parts production & assembly

PB: production block
SL: service link



FDI Attraction in East Asia Today

Traditional factors are relatively less important

- Abundant labor & low wage
- Availability of natural resources
- Large domestic demand

Policy is far more crucial today: provide two conditions below (& advertise!!!)

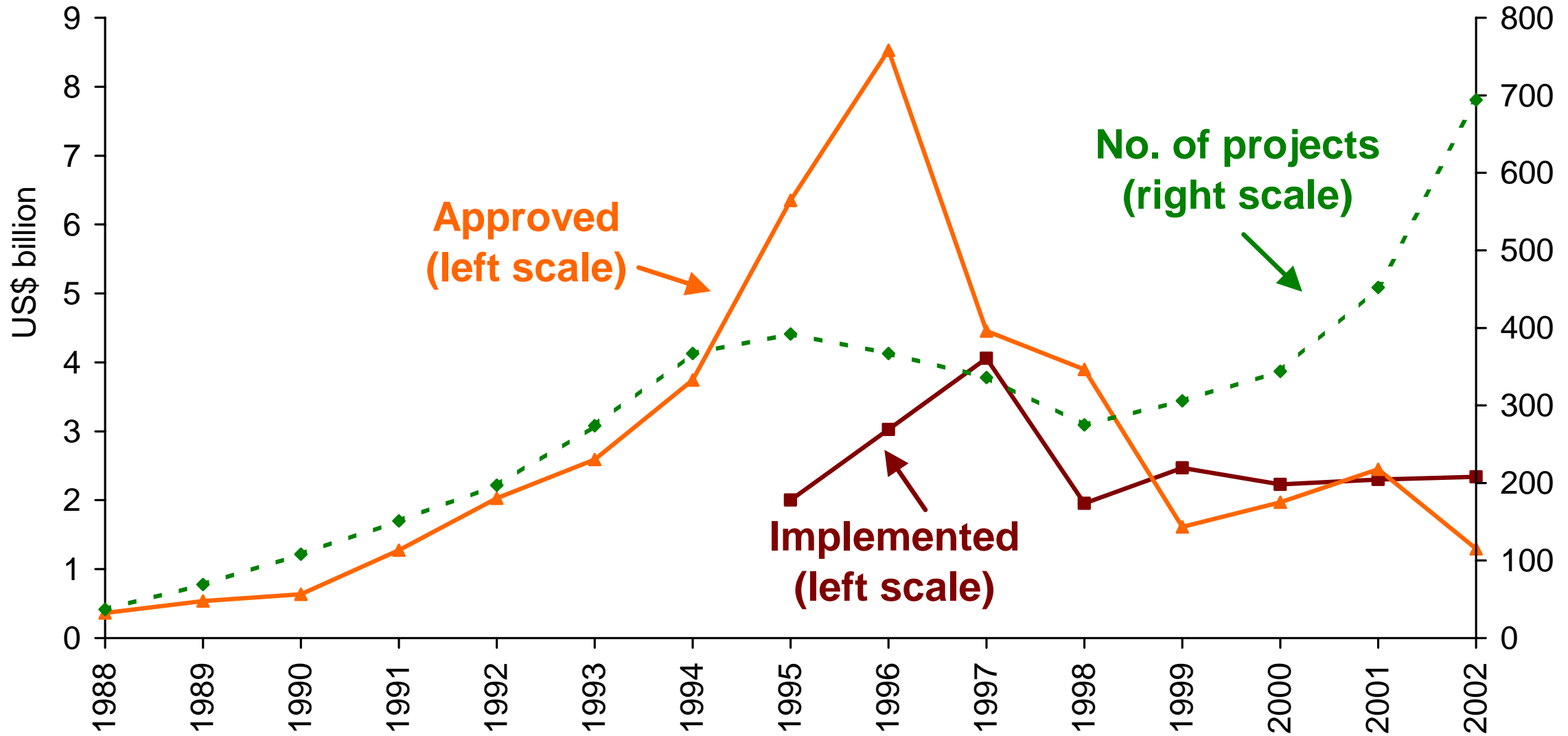
- (1) Open and stable investment climate
- (2) Low cost of doing business



Critical Mass of FDI: Not Yet

- By ASEAN standards, Vietnam has not received enough FDI for industrialization
- Large foreign exchange inflows now support land bubble, consumption & construction boom
- Prosperity without competitiveness is fragile and unsustainable

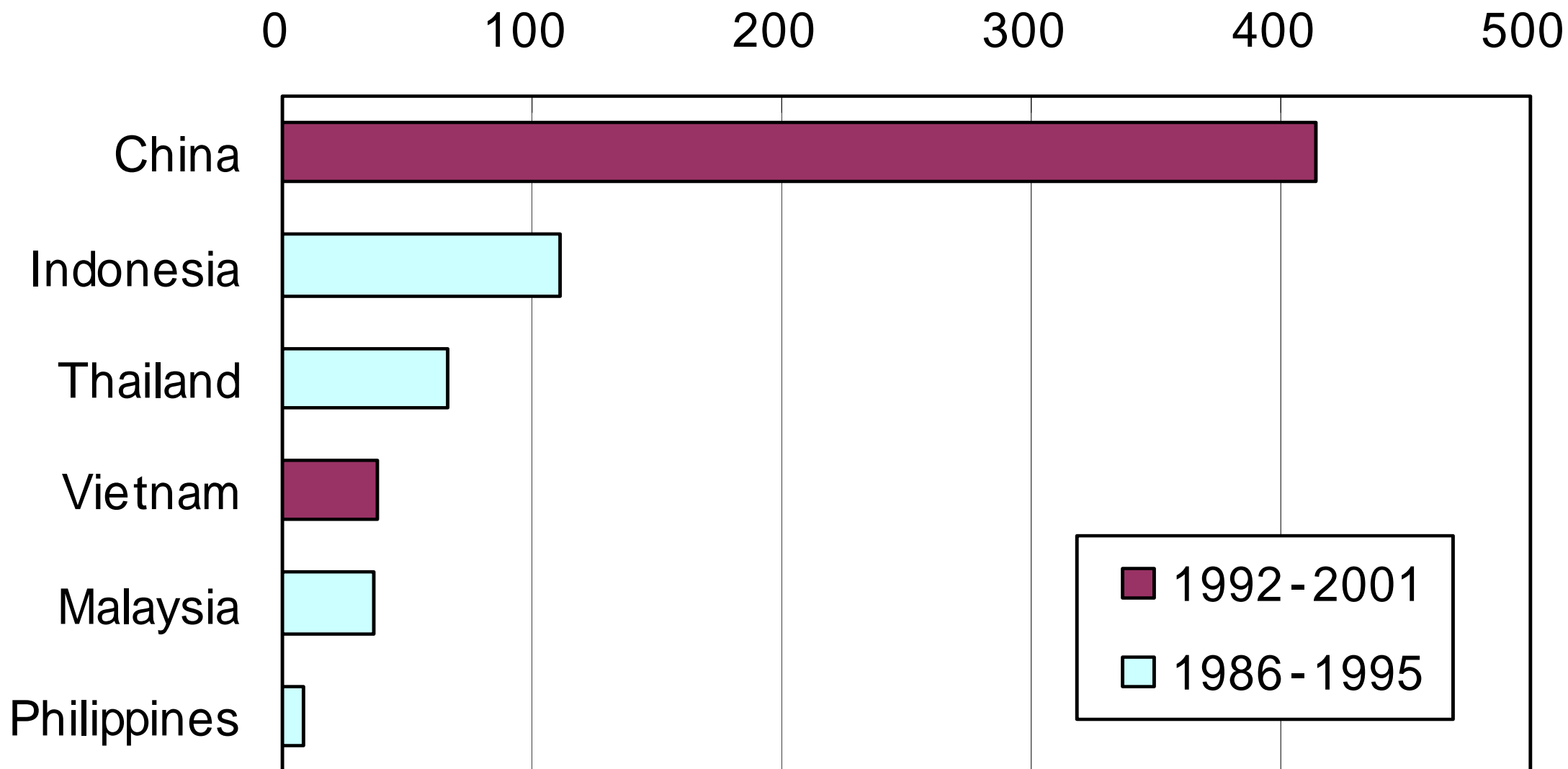
FDI Inflow into Vietnam



Source: Ministry of Planning and Investment.

Cumulative FDI Inflow

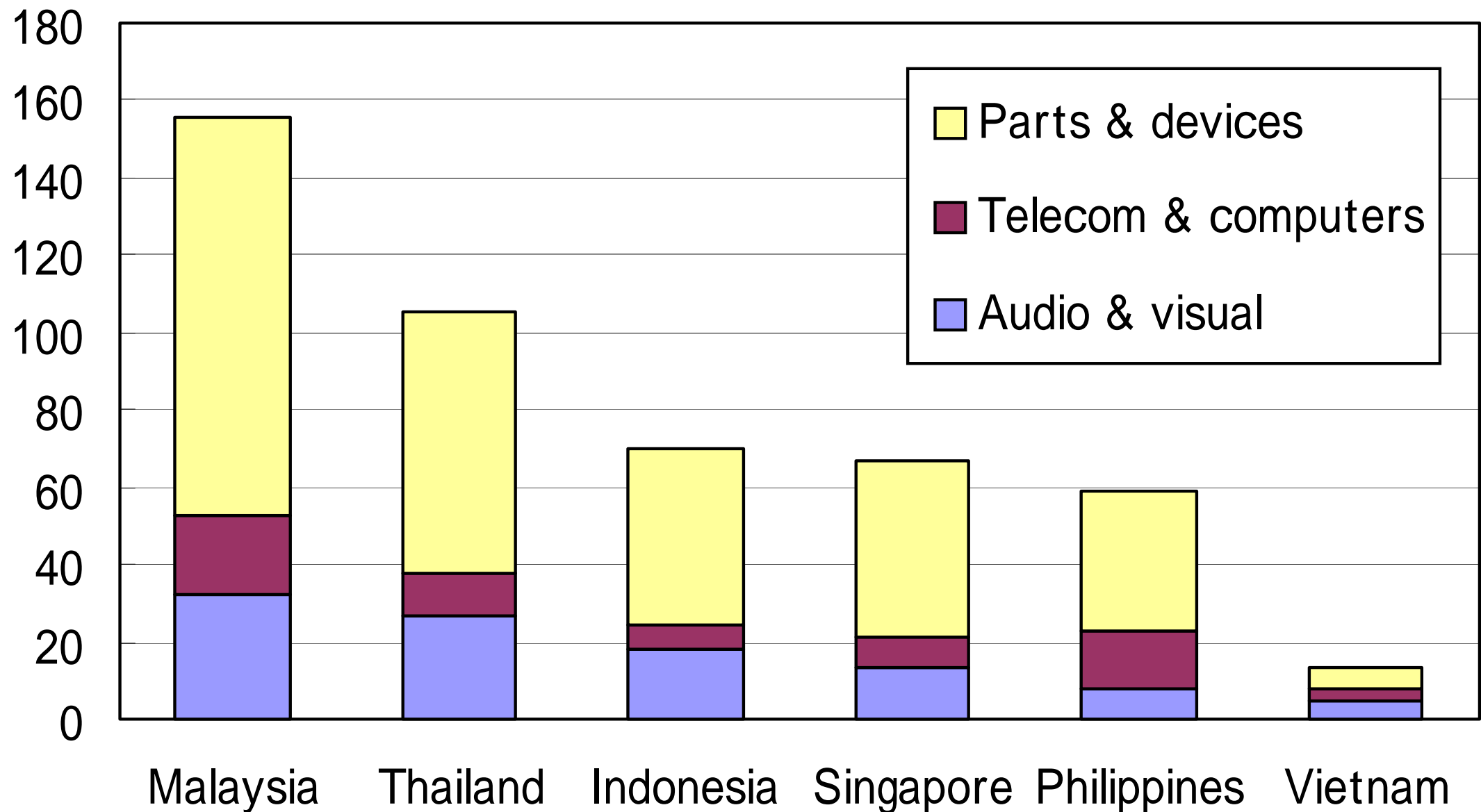
(Sum of commitments over 10 years, in USD billion)



Source: MPI; and Economic Planning Agency, *Asia Keizai 2000*. For China, Mitsubishi Research Institute, *China Information Handbook 2001*, Sososha, 2001.

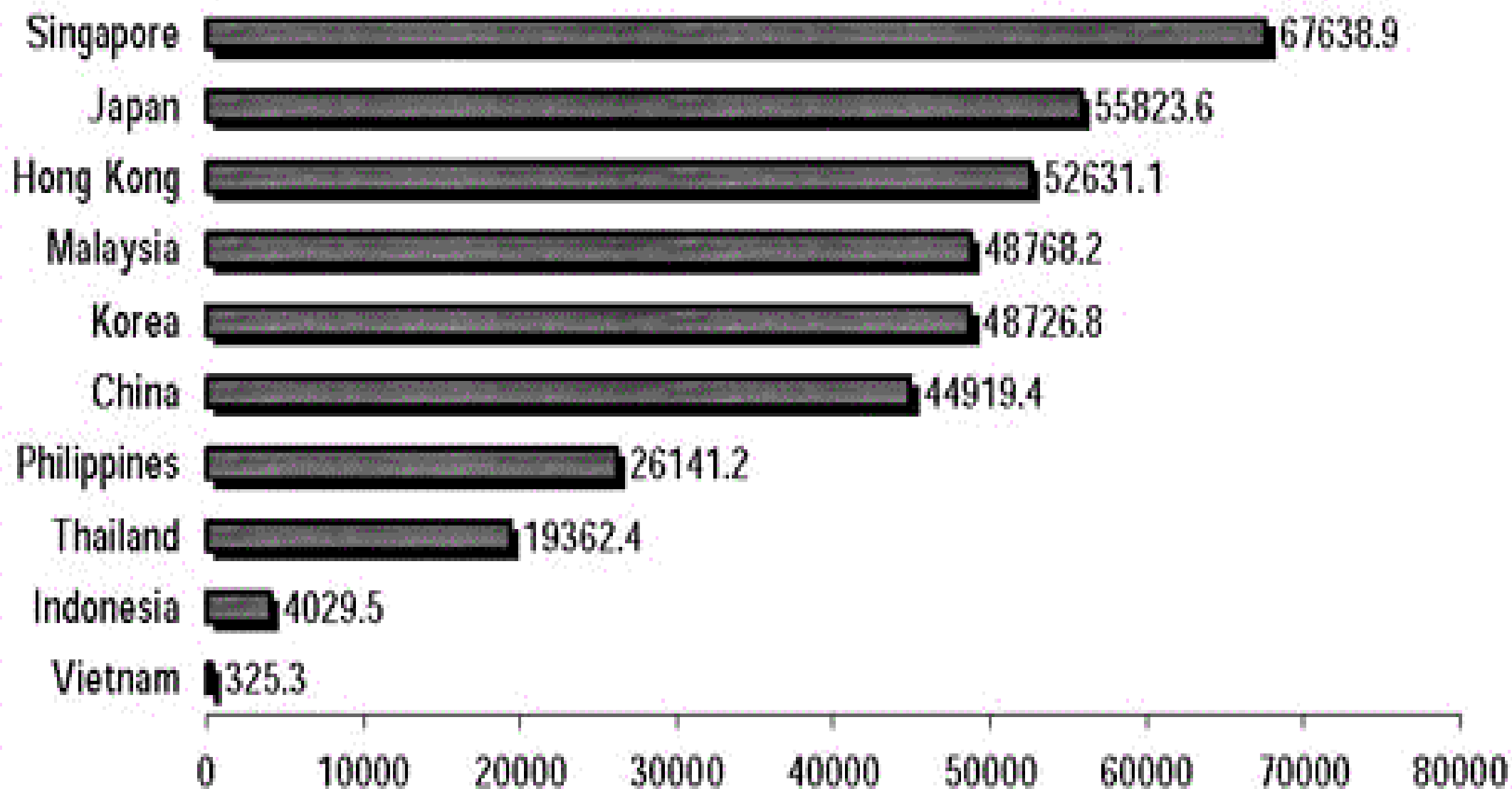
Japanese Electronics FDI in ASEAN

Cumulative number of manufacturing establishments



Source: Electronic Industries Association of Japan (2000), quoted by Yumiko Okamoto, "Electronics and Electrical Industries," in K. Ohno & N. Kawabata, eds, *Industrialization Strategy of Vietnam*, Nihon Hyoronsha (2003).

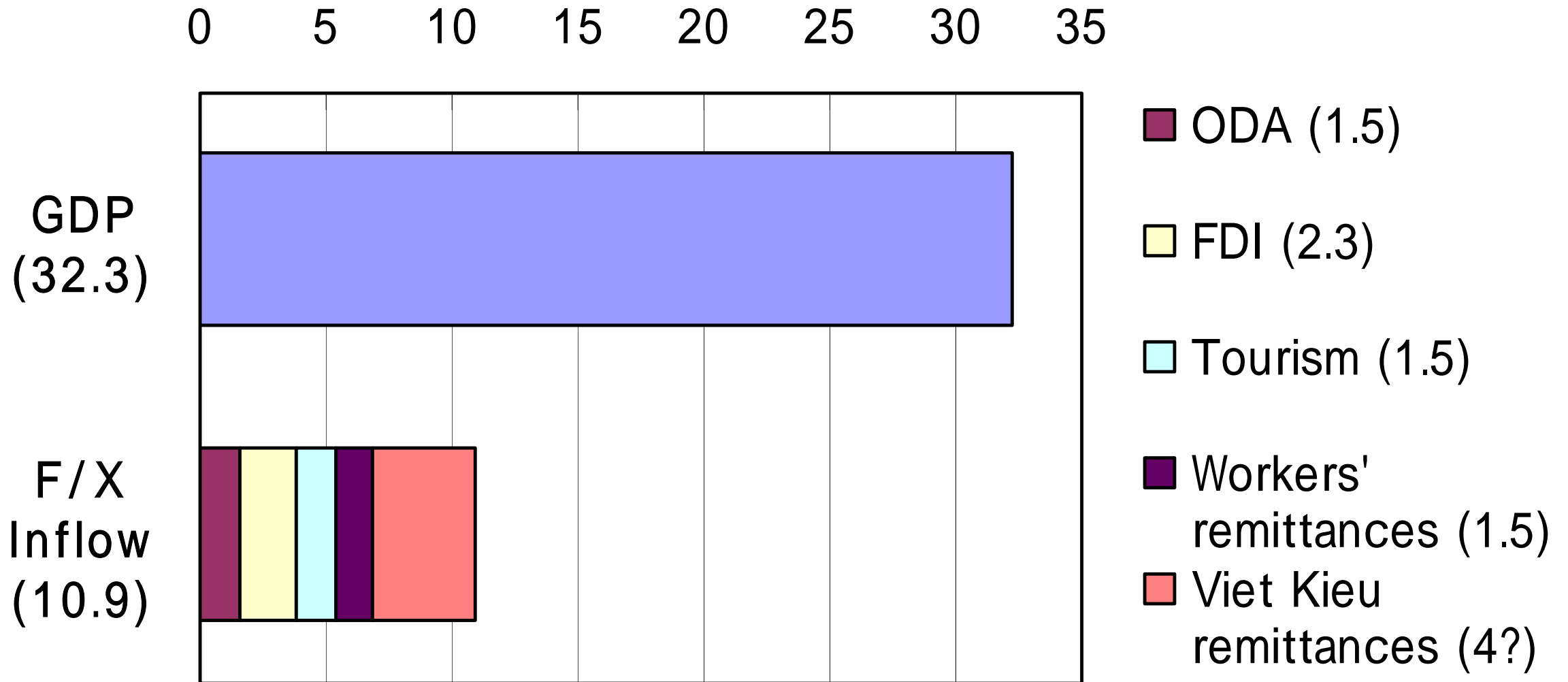
Figure 1 Total Export Value of Electronics Products by Country in 1999 (In Million US Dollars)



Source: United Nations International Trade Statistics Yearbook 2000.

Foreign Exchange Inflow into Vietnam

(In 2001, billions of USD)



Note: From various sources. Workers' and Viet Kieu remittances are estimates due to the existence of informal channels.

Improve FDI Policy Dramatically!!!

Slow improvements are not enough...

- Attract critical mass of FDI without selectivity
(high-tech or low-tech, export or domestic, etc doesn't matter)
- Reduce business costs as top national priority;
create No.1 FDI climate in ASEAN!!!
- For marketing & investor service, create VNIPA
(Vietnam Investment Promotion Agency)
 - MPI: policy formulation & guidance
 - VNIPA: actual marketing, service, trouble-shooting
(Recent MPI restructuring is not enough)



Localization Debate

Vietnam: “FDI firms are unwilling to use domestic parts”

Japan: “We are trying hard, but can’t find enough local firms with high quality”

Japan: “Liberalize parts import, and abolish local contents requirement !”

Vietnam: “How can we create supporting industries if we liberalize everything?”

Communication failure

Both sides (VN & JP) share the same goal of localization, but continue to criticize each other...

(1) Provide more opportunities for dialogue between local & FDI producers

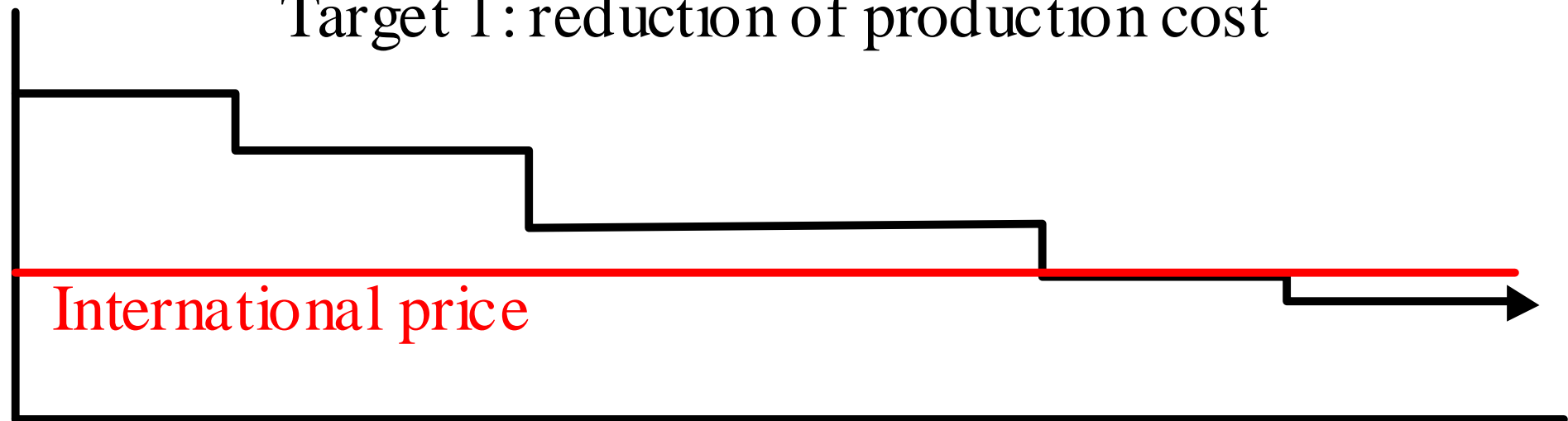
(2) Constructive engagement:

FDI firms should offer business targets
<cost reduction, localization ratio>

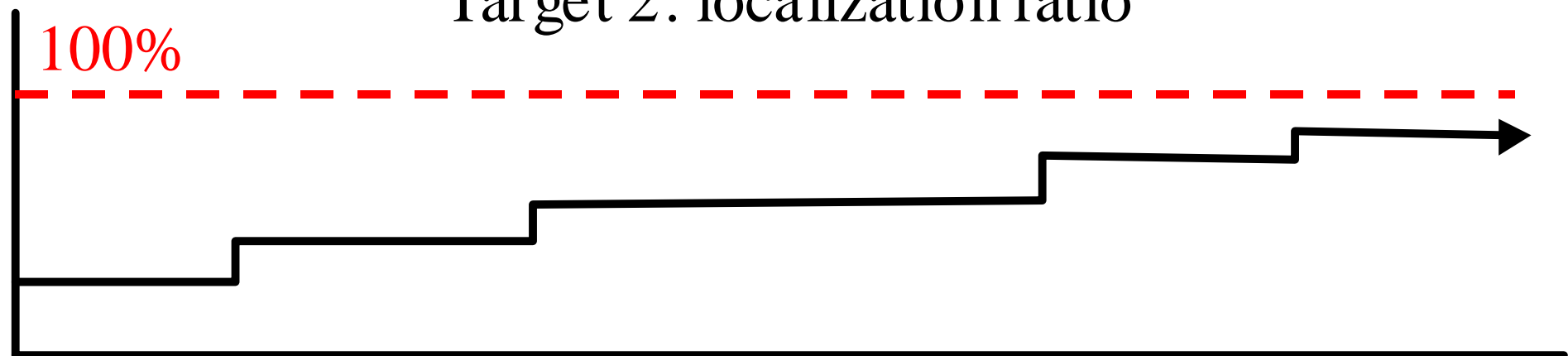
Gov't should support them with policies
<tariff design, promotion measures>

Conditional business targets that might be indicated by FDI firms (example)

Target 1: reduction of production cost

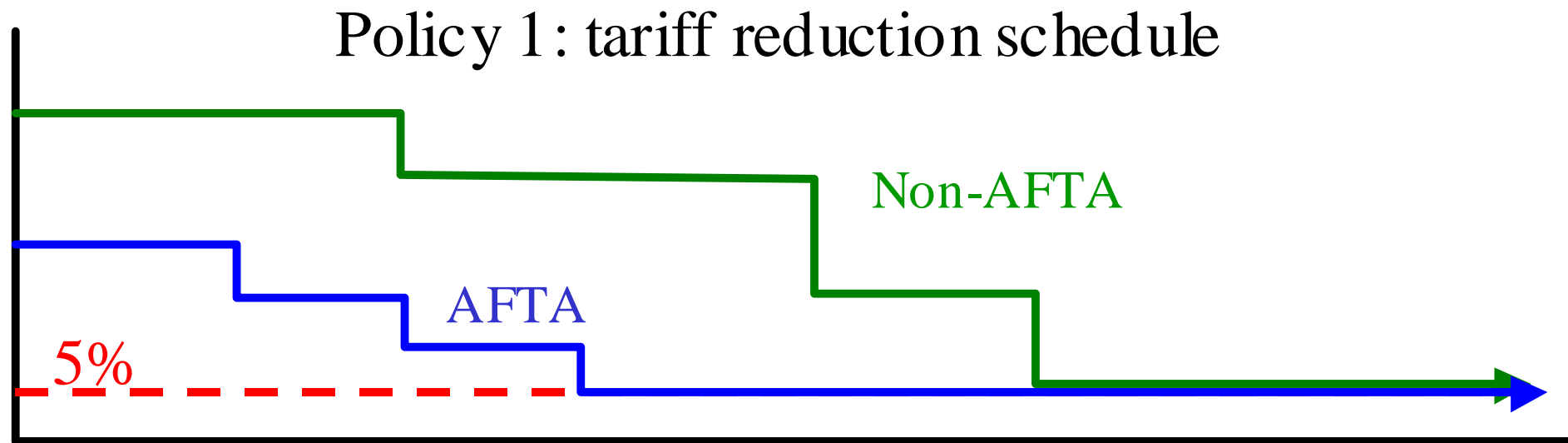


Target 2: localization ratio

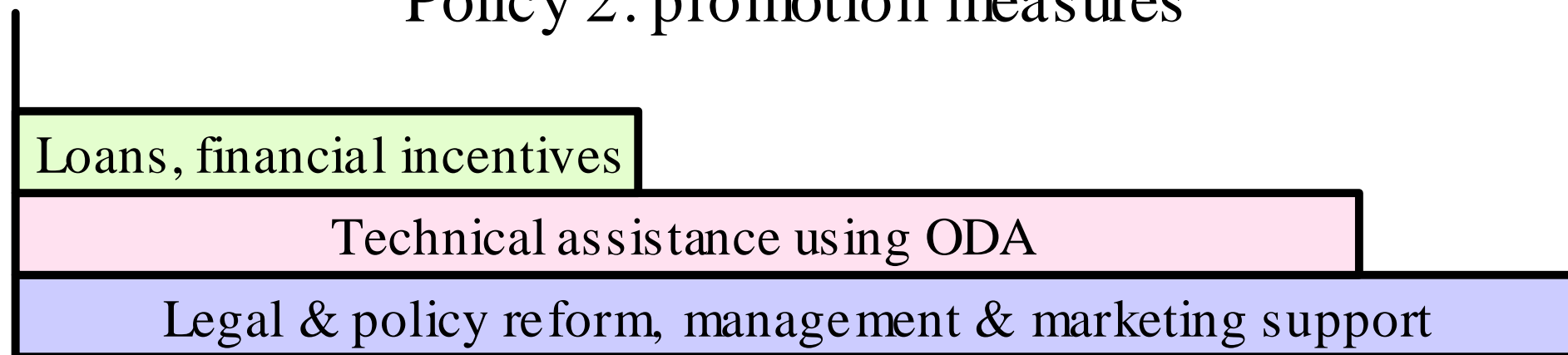


2003 2004 2005 2006 2007 2008 2009 2010 ...

Conditional policy actions that might be offered by Vietnamese government (example)



Policy 2: promotion measures



2003 2004 2005 2006 2007 2008 2009 2010 ...



Localization Must Be:

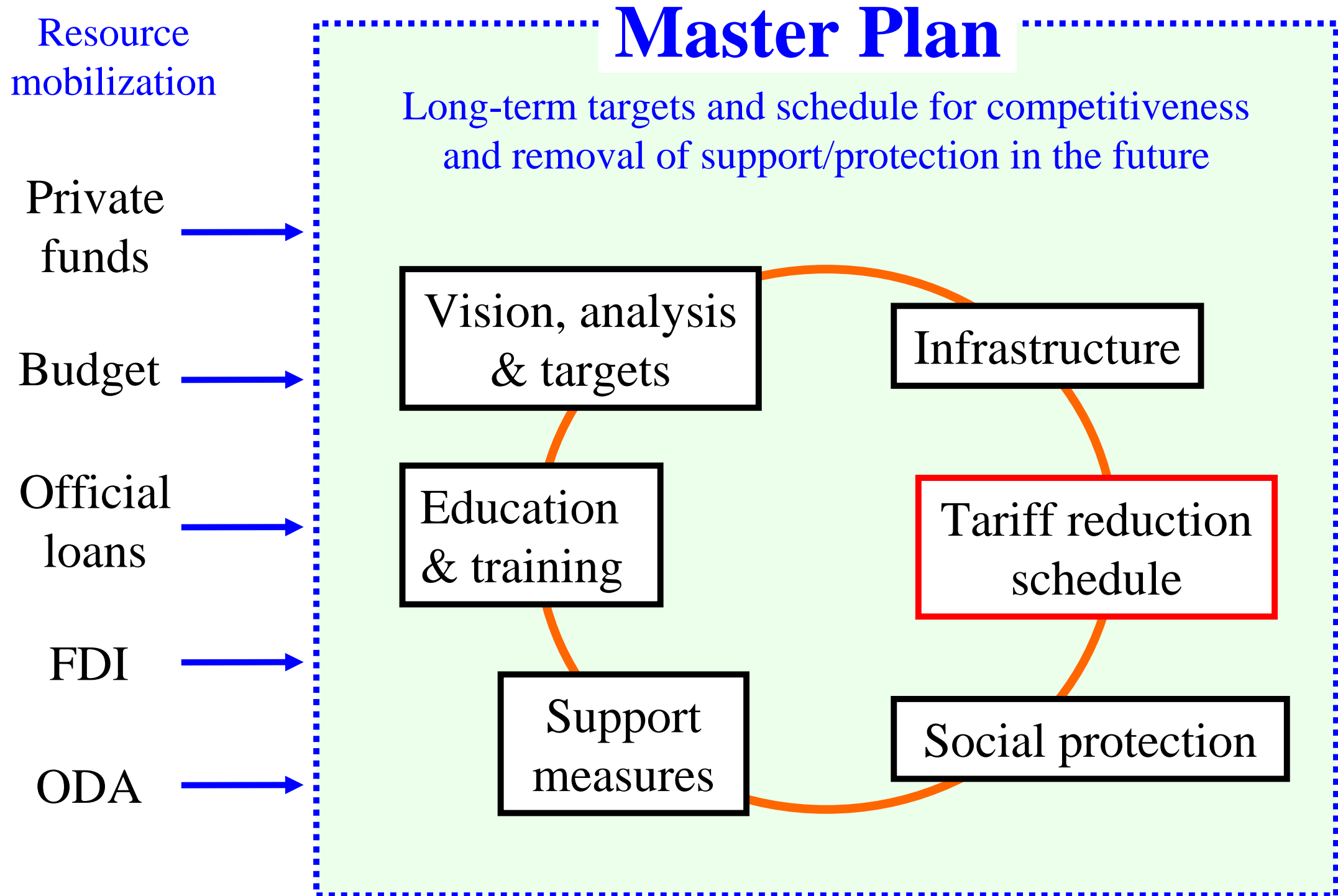
- Demand-led and natural (not forced or against market)
- Predictable with long-term schedule (not ad hoc revisions)
- Based on constructive engagement between producers and government (not mutual distrust)



Designing Tariff Reduction

- With only 2 years left, AFTA tariff reduction will begin to bite (affect prices & industries)
- Unfortunately, Vietnam didn't build competitiveness sufficiently since 1996
- Proper rules must be observed in tariff design (current tariff policy is inconsistent & ad hoc)

Ensuring Policy Consistency under a Clear Vision



Tariff Design Rules

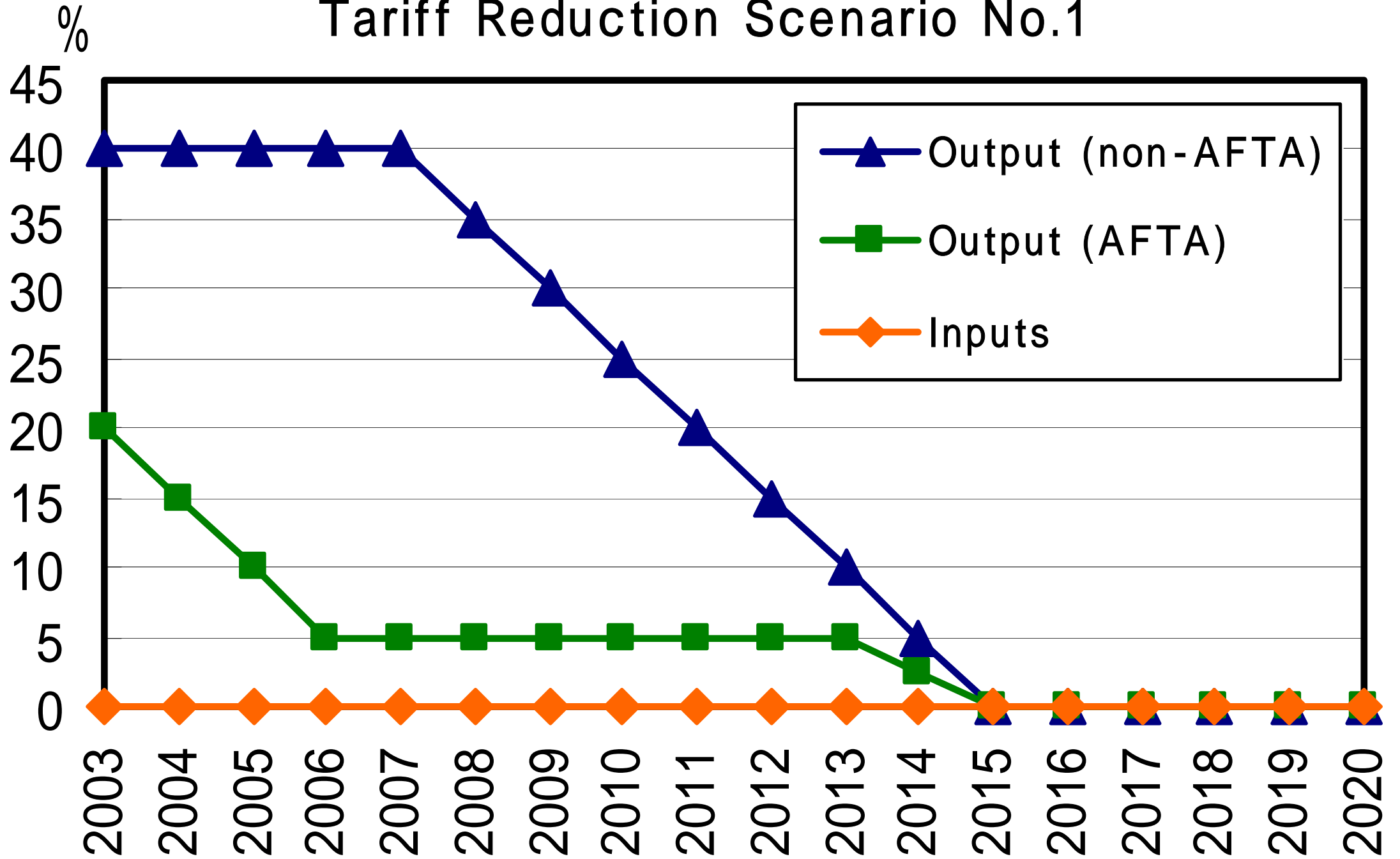
- Vertical consistency
(parts tariff < finished product tariff)
- Secure minimum profitability for startup
(for newly created industries)
- Consider cost effects on users
- No tariffs on inputs of export firms (even better:
no tariffs on all industrial inputs)
- Protect domestic producers & users against
unfair trade & global market instability

For Import-Substitution Industries (both local & FDI)

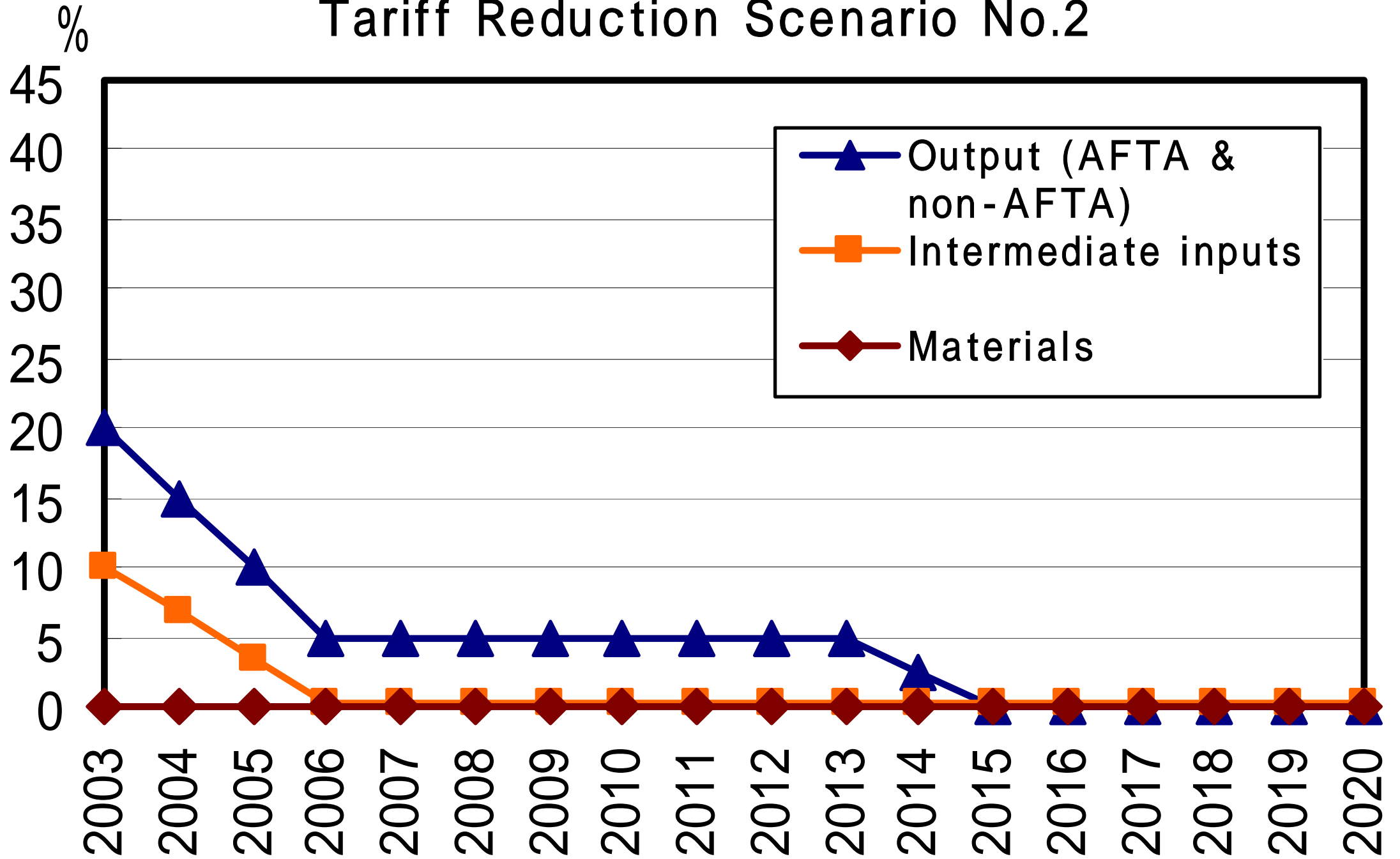
Currently weak & protected; threatened by AFTA implementation

- Design properly and announce tariff reduction schedule (and stick to it)
- Let market decide ultimately; but
- Assist firms with realistic plans for competitiveness

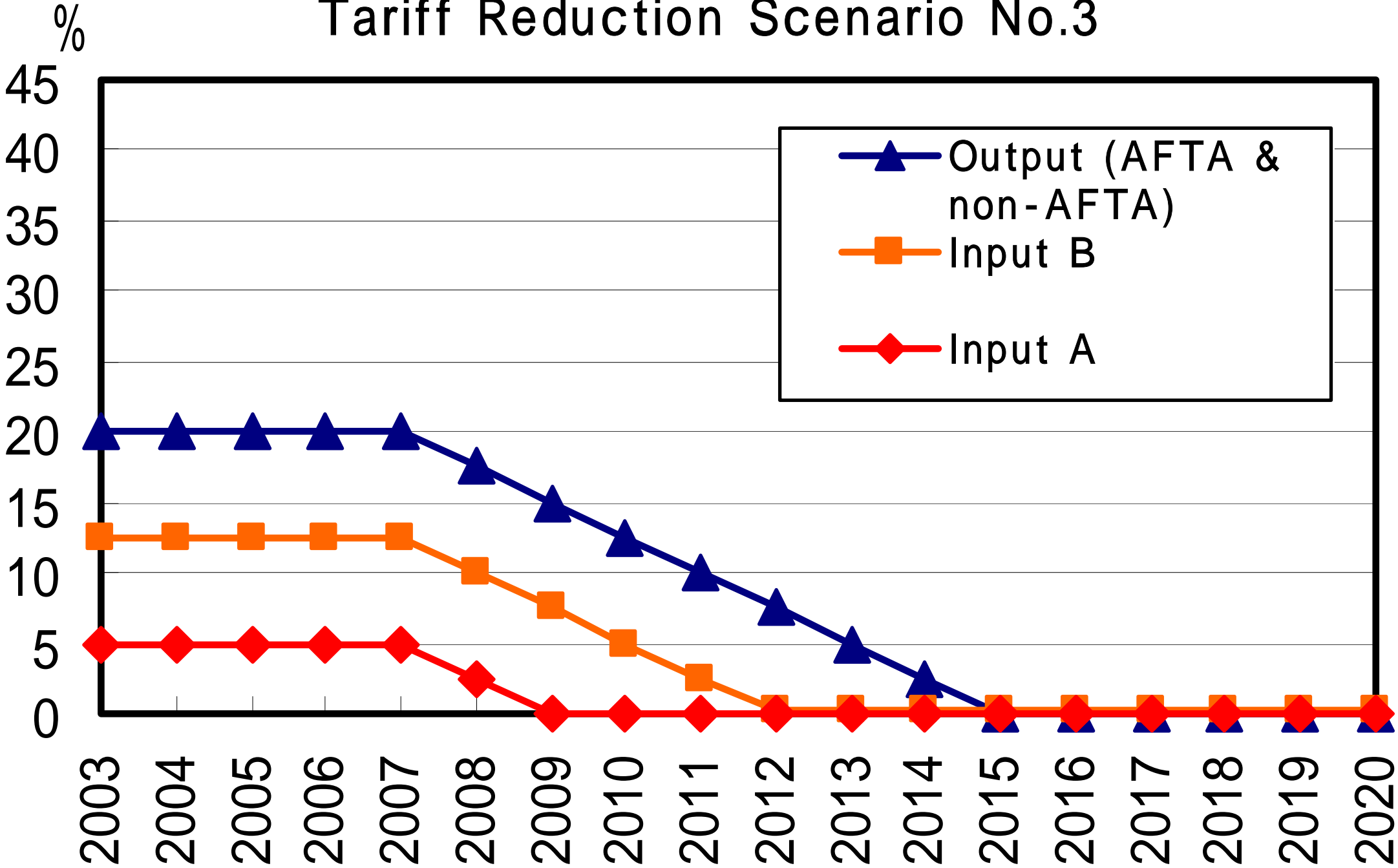
Tariff Reduction Scenario No.1



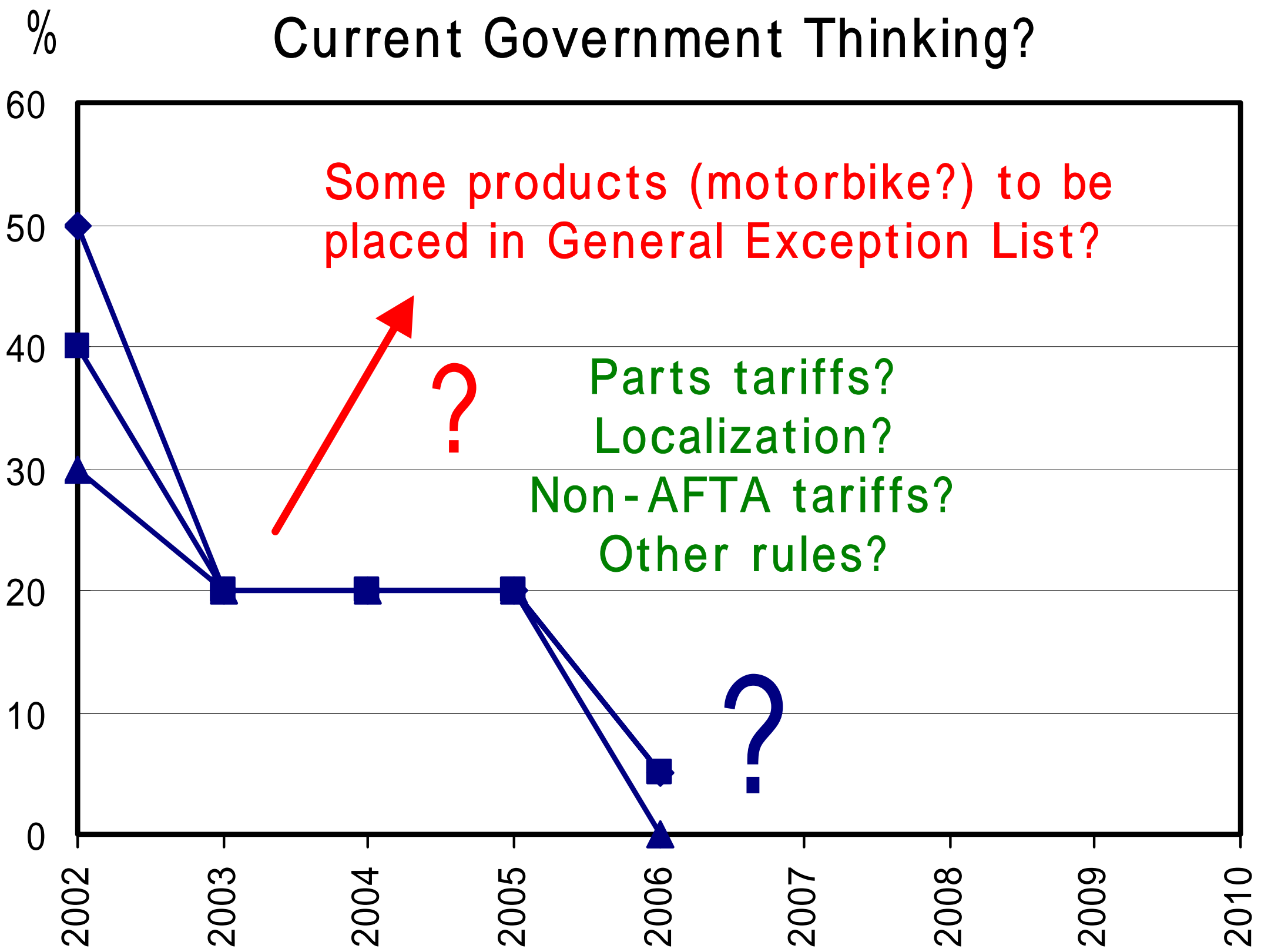
Tariff Reduction Scenario No.2



Tariff Reduction Scenario No.3



Current Government Thinking?



Some products (motorbike?) to be placed in General Exception List?

?

Parts tariffs?

Localization?

Non-AFTA tariffs?

Other rules?

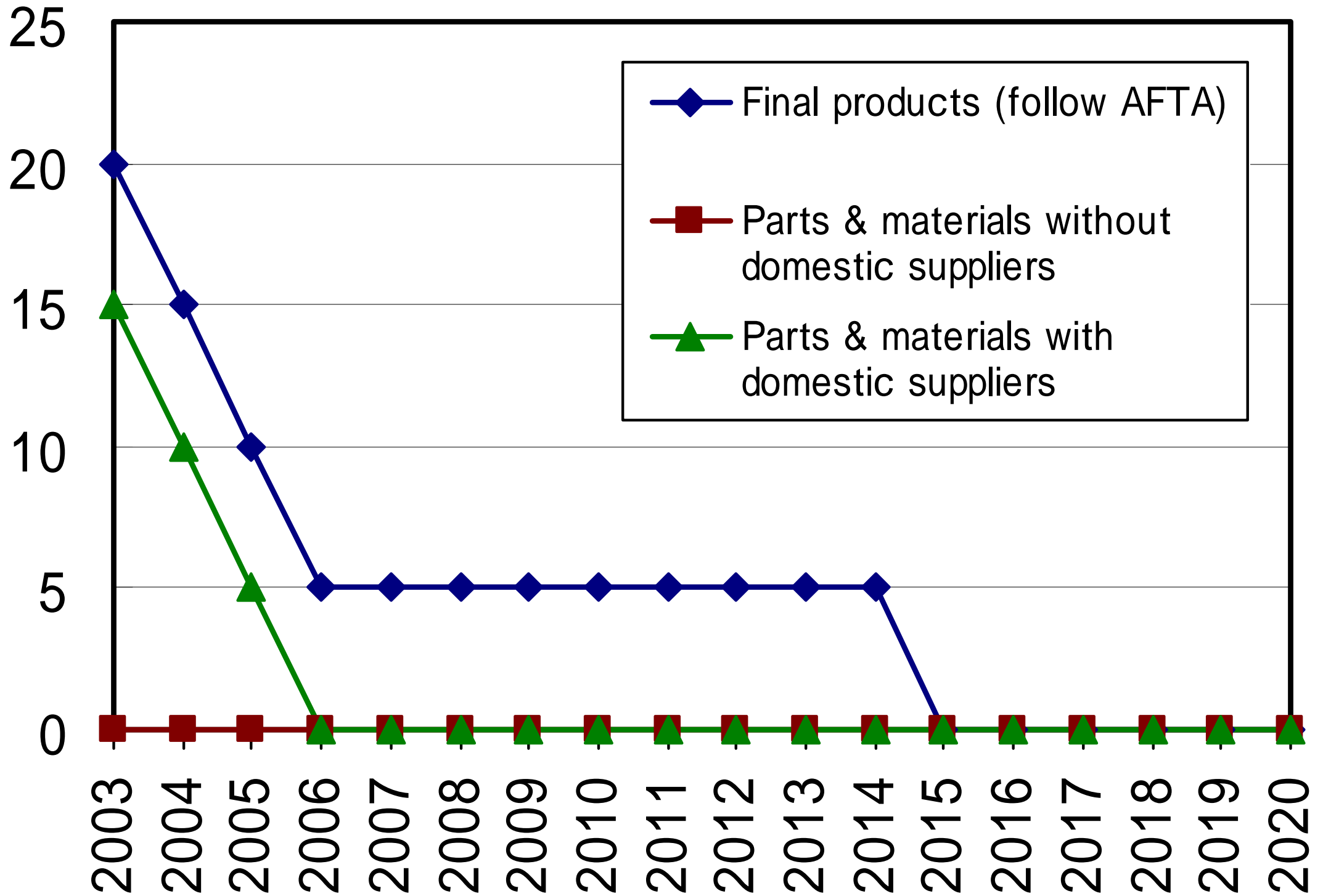
?



Electronics Industry

- Official interest in IT & software only; neglect of hardware (no strategy or master plan yet)
- Problem of the 2003 CEPT revision
 - Reverse tariff structure (parts > finished products)
 - Finished imports cheaper than domestic assembly
- Local contents & “kitting” requirements which push up cost beyond apparent tariff rates

Suggested CEPT Structure for Electronics

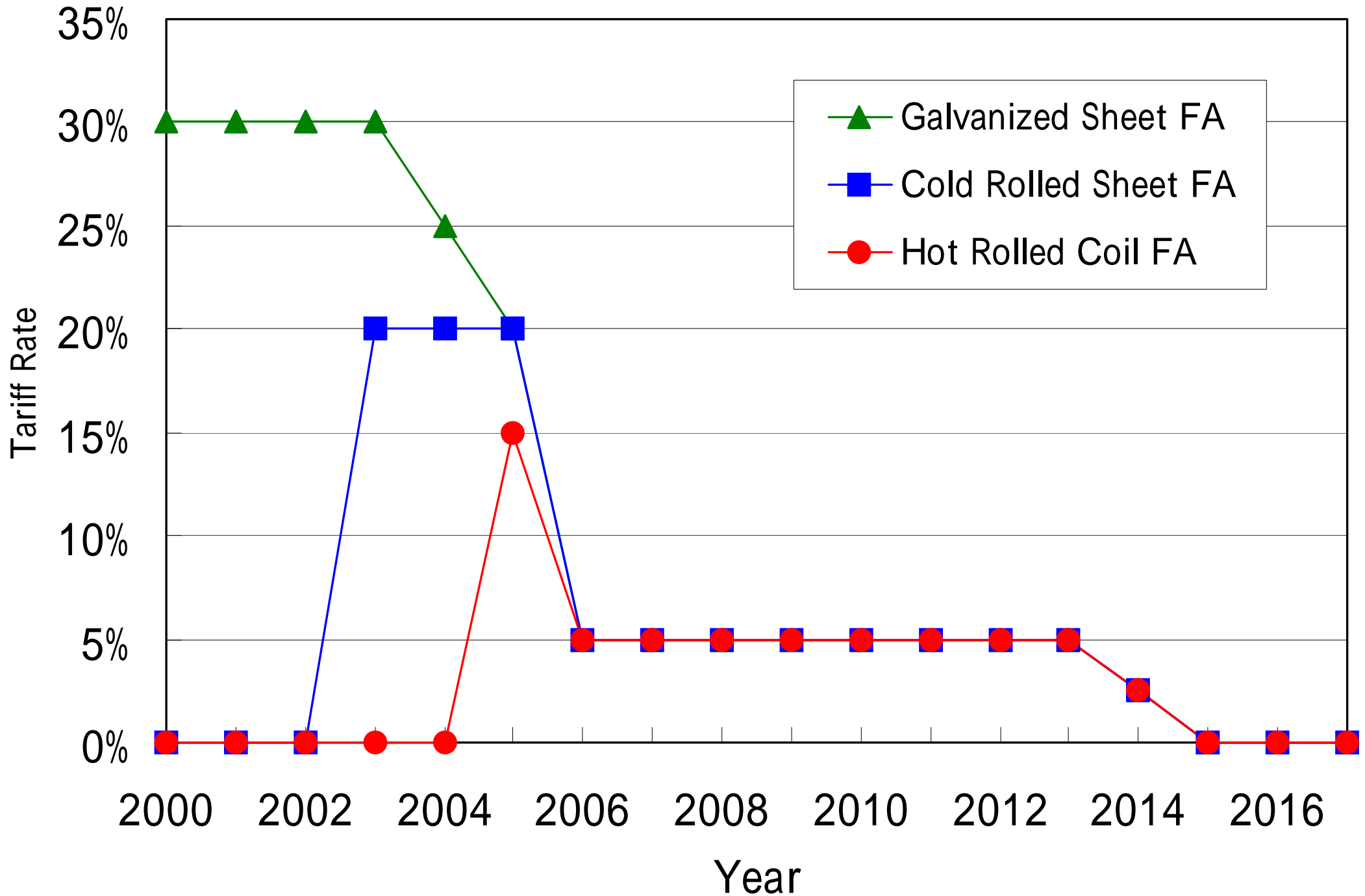




Steel Industry

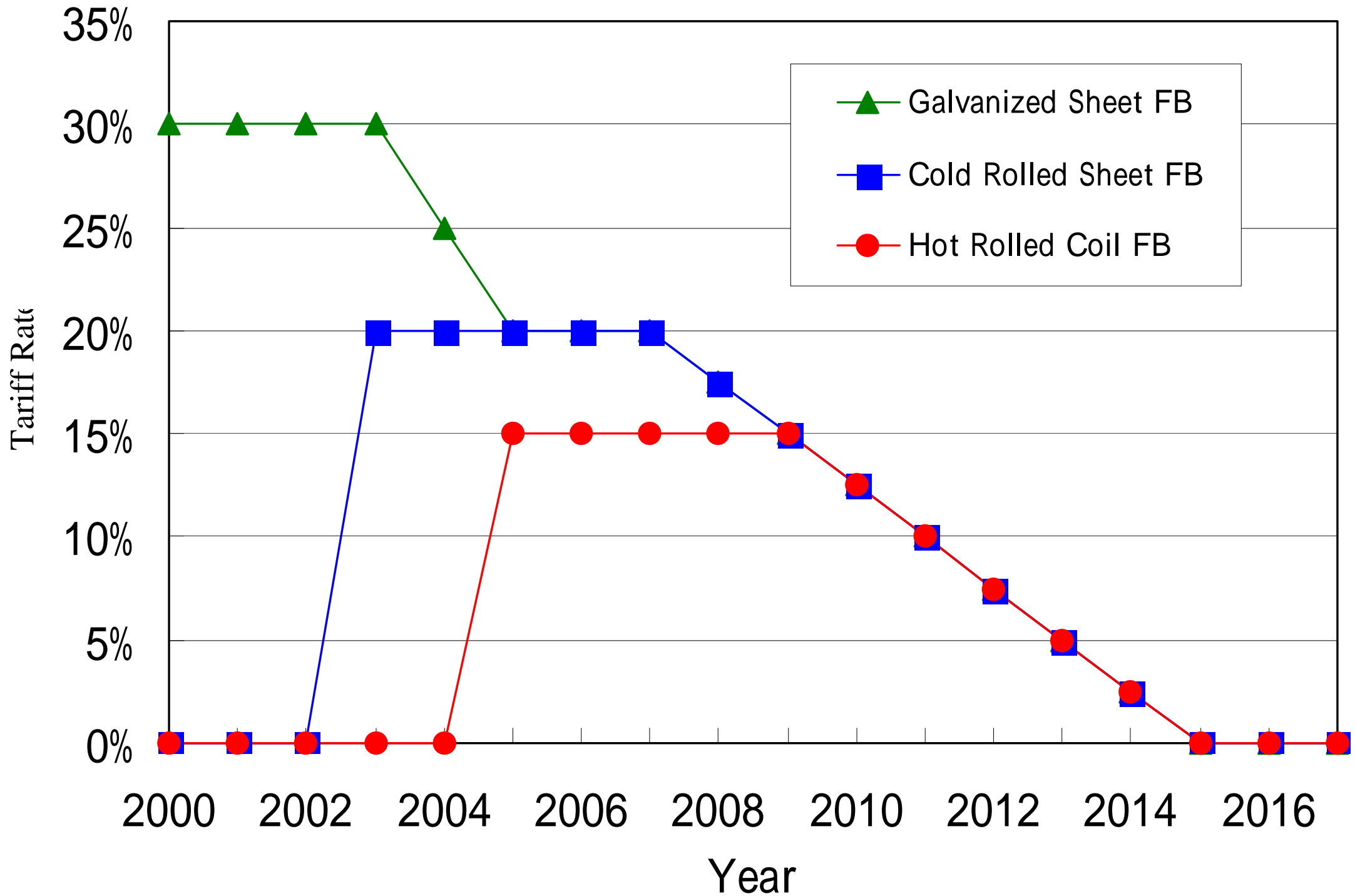
- Heated debate over new integrated steel works (\$6-7 billion!) → Irrelevant
- Vietnam must solve two urgent problems or there is no future for steel industry
 - (1) Long products: solving imbalance--oversupply of output & shortage of input (billet)
 - (2) Flat products: VN's first cold rolling mill (CRM) and billet center must be started (2004?) & operated smoothly without huge loss

Tariff Reduction Scenario for Flat Products (FA)



Note: Assuming CRM in 2003 and HSM in 2005 (actually delayed)

Tariff Reduction Scenario for Flat Products (FB)



Note: Assuming CRM in 2003 and HSM in 2005 (actually delayed)



Industrial Parks

- IZs/EPZs receive 36% of manufacturing FDI to Vietnam (end 2002)
- Some IPs are successful, but not others
- 3 Keys to success:
 - (1) Location!!! (suburbs of HN/HCMC is best)
 - (2) Infrastructure service (high quality, low cost)
 - (3) Management capability

Information Gap

- No easy way to collect info on VN's industrial parks (visit them, phone them...?)
 - Proposed VNIPA should promote PR
 - Meanwhile, GRIPS is collecting IZ/EPZ info: see www.grips.ac.jp/vietnam/VNIPs
 - JICA also helped MPI to create a web: www.vietnamfdi.com (but only in Japanese)
- ➔ Helpful Website is the first step to reach out to potential investors

The End

Meanwhile, research on Vietnamese industries will continue at VDF...