

Designing a Comprehensive and Realistic Industrial Strategy

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This paper raises a number of issues that should be considered in revising Vietnam's overall industrial strategy. Our purpose here is to offer some sharply formulated ideas to initiate discussion for our future study. The proposals contained below partly reflect the conclusions of the previous NEU-JICA joint research (2000-03) but new arguments are also added.

1. Weaknesses in industrial policy making

Vietnam's industrial policy is often said to be inconsistent and unpredictable. There are three different levels of the alleged problem.

First, *the fundamental direction of overall industrialization strategy remains unclear*. The national goal is to become an industrial country by 2020. Some growth targets up to 2010 are given numerically in the official documents (the Five-Year Plan and the Ten-Year Strategy). Beyond these, however, details are not spelled out. The missing "details" include, for example:

- What does it mean, concretely, to be an industrial country by 2020?
- What is the roadmap (with interim targets) from now to 2020?
- Which industries will (or should) be the growth engine?
- What are the roles of SOEs, SMEs and FDI, respectively?
- What should be the strategy for coping with international integration?
- How should government and market be blended in Vietnam's industrialization?
- How should supporting industries and upstream investment be promoted?

Second, *the strategies for individual key industries are nonexistent or poorly formulated*. While MOI has produced a fairly large number of master plans for individual industries, the quality of these master plans generally falls short of the required level in the age of globalization. In particular, industrial targets are defined in terms of physical quantities (production, exports, domestic supply ratio, investments, etc) rather than Vietnam's relative position in global competition (cost, quality, quick response, design, marketing, etc). Moreover, policy measures to improve competitiveness are not proposed concretely or realistically. This largely comes from the absence of good analysis on the current global competition.

Third, *economic decision making is decentralized and industrial policy is not unified*. Different policy components which should be integrated actually conflict with each other, both horizontally and vertically. Different ministries formulate policies without much coordination. Conflicts between central and local authorities and implementing agencies are not resolved. Various policy components (industrial promotion, WTO negotiation, FDI attraction, tariff and tax structure, public investment, etc) are not mutually enhancing.

This paper mainly concentrates on the first level, namely the questions related to overall industrial strategy making. The other two levels are equally important but will not be our main focus below (for these, please see the NEU-JICA study¹).

2. Defining an industrial country

What does it mean, concretely, to become an industrial country? This question should be answered in a practical way which reduces uncertainty and encourages development, rather than in a purely academic way. In fact, there is no easy way to theoretically define an industrial country². In this sense, the problem is a practical and strategic one regarding how Vietnam should use its national goal to accelerate development.

The national goal should be ambitious but achievable under good effort. It should reflect the reality of Vietnam as well as the global economy. If the goal seems clearly unreachable, it loses meaning and credibility. Vietnam has already declared the goal of joining the ranks of industrial countries by 2020 and cannot retract it politically, but its precise definition has not been given. The ambiguity may be partly intentional, but we believe it is time to specify its content more explicitly. This will improve the quality of industrial policy formulation and reduce the uncertainty that currently plagues business enterprises.

We propose the following approach to thinking about industrialization.

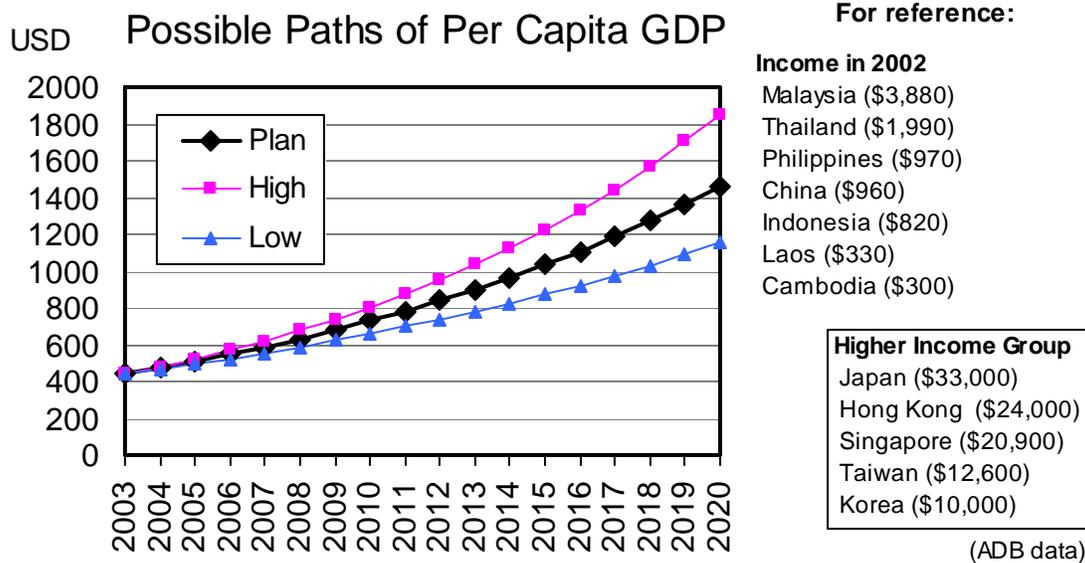
First of all, the target for 2020 should not be too high. In sixteen more years, it is hardly possible for Vietnam to become a full-fledged industrial economy on a par with the US, EU or Japan. Within that time framework, it is also difficult to even reach the level of Taiwan or Korea which possess capabilities to produce a broad range of products with little foreign assistance (Section 8). The goal for Vietnam in 2020 should be more modest. It should be an industrialization based on skilled labor-intensive manufacturing, which is a part of the entire manufacturing activities. The goal for 2020 should be to become an emerging industrial country with a leading position in a few selected manufacturing processes in the global market, rather than a fully industrialized country.

Industrialization should not be measured by the absolute level of per capita income. Surely, income growth is an important signal of successful development. But the absolute income level should be a suggestive indicator only and not an official target. There is no theory to precisely tell us an income level that corresponds to an industrial country. The important thing is that income continues to rise steadily and at a speed reflecting the nation's growth potential.

¹ JICA-NEU, *Chinh sach cong nghiep va thuong mai cua Viet Nam trong boi canh hoi nhap*, 2 tap, NXB Thong ke, 2003; and GRIPS Mo dun thong tin, "Chien luoc cong nghiep hoa cua Viet Nam trong ky nguyen toan cau hoa," NEU-JICA, thang 8, 2003. Both documents are also available in English and partly in Japanese.

² Theoretically, *industrialization* can be defined to be a process of continuous expansion of manufacturing industries as a growth engine (see below). However, there is no clear-cut definition of an *industrial country* or the exact end-point of such a process. For more discussion, see Section 7 below.

Given the initial income level and a reasonable growth rate, the range of possible future income is easily calculated. For Vietnam, per capita income targets of \$730 in 2010 and \$1,460 in 2020 are consistent with the official documents and should be achievable if policy and economic environment are favorable. If the annual growth is 1.5% lower or higher than this benchmark, income will be between \$1,150 (bad case) and \$1,850 (good case) by 2020. It is difficult to expect an outcome far outside this range. Setting the income target much above this is not practical. Furthermore, these numbers are expressed in today's dollar value and must be adjusted for price and exchange rate changes. This makes the pursuit of absolute income targets even more ambiguous and complicated.



In economic history, industrialization is normally defined as a process satisfying the following conditions:

- *Durability*—manufacturing industries³ grow continuously at a high speed (often at double digits for a few decades or more)
- *Contribution to overall growth*—manufacturing industries are the largest contributing factor to GDP growth (i.e., it is not just a small part of the national economy).
- *Structural change*—the content of manufacturing industries shifts constantly from simple processing to more complex production requiring high technology.

But this is a definition of an *industrializing* country (process), not an *industrialized* country (state). For the latter, we must improvise a new definition. We would like to propose the following five criteria for Vietnam with special attention to its integration into East Asian dynamism:

³ This is a narrow definition. The broader definition of industrialization additionally includes the growth of mining, construction, transportation, telecommunication and public utilities which are closely related to the growth of manufacturing. In this paper, we prefer to use the narrow definition.

- *Relative income*—Vietnam joins the rank of successful East Asian countries with an income level comparable to its middle group (China and ASEAN4). This is a relative income target rather than an absolute one discussed above. At present, Vietnam belongs to the lowest income group in East Asia rather than the middle income group.
- *Export structure*—manufactured goods⁴ account for at least (75%)⁵ of exports. This means that Vietnam no longer exports primary commodities mainly but its export base has definitely shifted to manufacturing.
- *Selected leading status in high-quality manufacturing*—the country achieves a leading status in at least a few high-quality manufactured products or processes in the global market. This requires an agglomeration of production which enables Vietnam to become one of the largest exporters of that product in the world. Moreover, this should be realized through good quality and reputation, not through large quantity driven by low price and low quality. For this, a full mobilization of Vietnamese workers’ potentiality is the key (Section 5).
- *Establishment of supporting industries*—in the leading industries noted above, there is a healthy growth of supporting industries (parts and materials) so that localization ratios are high. For important industries such as garment, electronics, motorbike, etc. medium-term targets for localization should be set in close consultation with domestic and FDI producers and with periodic revisions as necessary. However, 100% localization (full vertical integration under self-sufficiency) is not desirable in the age of globalization and international division of labor. Vietnam should establish a regional production network with Southern China and the rest of ASEAN, exporting some parts to them and outsourcing some inputs from them. What level of localization should be optimal should be determined from a strategic viewpoint.
- *Internalization of supporting services*—domestic skills that support high-quality manufacturing are available so that it is no longer necessary to rely heavily on foreigners. At least (70%) of skilled labor inputs should be domestically supplied and only very specialized skills should be sourced externally. Needed skills include policy design, production management, global marketing, “land marketing” (advertisement for FDI and industrial parks), product design and so on.

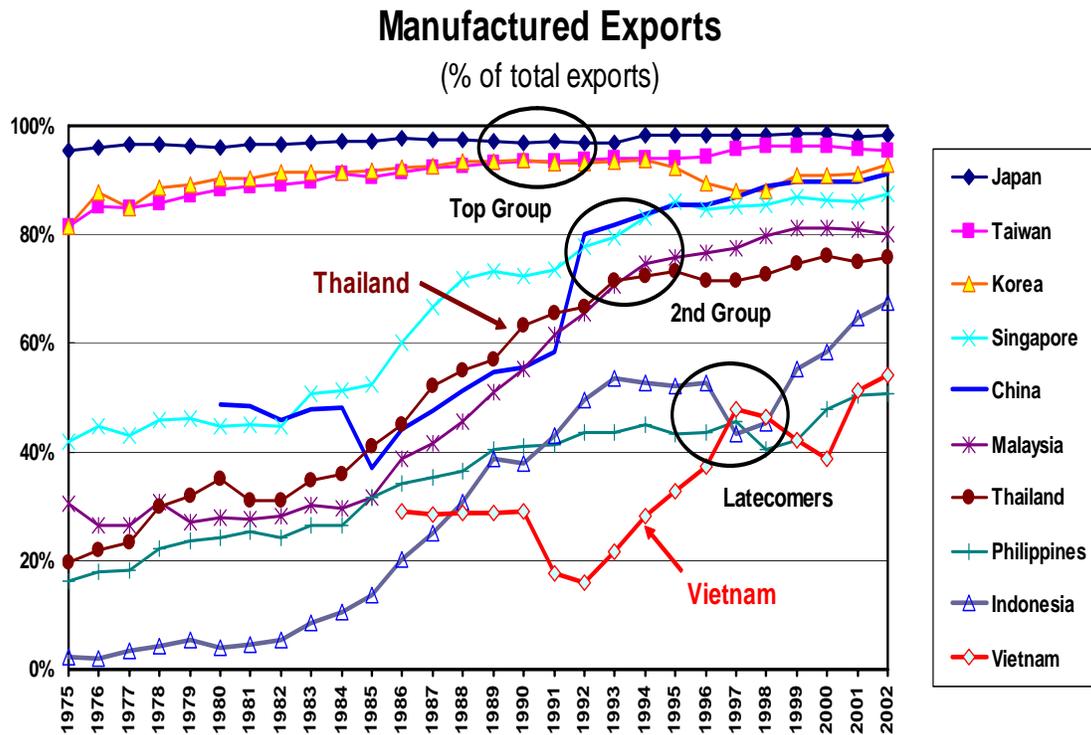
To define the industrial targets for 2020, experiences of other East Asian countries are highly suggestive. In particular, Thailand should be a good reference country for Vietnam’s policy making. Today’s Thailand has an income level close to what Vietnam can achieve in 2020. It belongs to a group of successful middle-income countries in East Asia with manufactured products accounting for 75.6% of total exports. Thailand excels in selected areas of high-quality manufacturing such as electronics and automobile. It also has relatively well-developed supporting industries for these industries. However, there are also shortcomings. The long-term potential of Thai workers does not seem as good as in Vietnam and the internalization of supporting skills (technical transfer) still

⁴ We define manufactured goods to be those belonging to SITC codes 5, 6, 7 and 8. Alternative definitions are also possible.

⁵ The numbers in parentheses here and below are preliminary suggestions only, to be finalized with more careful analysis.

remains low. Thailand also did not succeed in reducing income gaps within the country and slowing labor migration into Bangkok.

Thailand will probably continue to grow and be more developed by 2020. Our idea is not that Vietnam should copy the development path of Thailand but use it only for a useful reference point. Vietnam should aim at the industrial achievements of today's Thailand at the least, and try to do even better than Thailand in some aspects including internalization of supporting activities, use of highly skilled labor force, income equity and controlling urban congestion, by 2020 (or even sooner). We believe this is a realistic goal. When this is achieved, Vietnam can aim at even higher targets in the following decades (Section 8).



Source: ADB, *Key Indicators of Developing Asian and Pacific Countries*, 2003/2001/1993; IMF, *International Financial Statistics Yearbook* 1990. For Japan, *Japan Statistical Yearbook 2003/2002/1999*, Statistics Bureau/Statistical Research and Training Institute, Ministry of Public Management, Home Affairs, Posts and Telecommunications, Japan.

3. Fundamental strategy

The fundamental orientation of industrial strategy is very important. But after ten years of intensive global integration, Vietnam should not be debating it forever. The country should decide what to do and implement necessary policies as soon as possible. In an uncertain world, we cannot wait for perfect answers. Even if information is incomplete, Vietnam must act now in order not to miss the dynamic opportunity. We believe it is high time for Vietnam to clearly announce its desired development path.

Officially, Vietnam has adopted the multi-sector economic principle which accepts the contribution of all sectors: farmers, family businesses, private enterprises, cooperatives, SOEs and foreign-invested enterprises. But the role of each sector has not been clearly specified in the process of industrialization and modernization. In particular, the question of which sector should lead the national economy has not been resolved despite the heated debate since the 1990s.

There are several alternative views concerning this matter.

The state-led view argues that the state, not the market, should guide and direct the development process. Otherwise, growth will be too slow or imbalanced. If the private sector is unwilling to invest upstream or promote localization, the state must invest or strongly guide the private sector to do so. SOEs should also play an important role. This view contends that vertical (upstream) development of key industries is essential for economic security and full-fledged industrialization.

The FDI-led view argues that policy should supplement the market rather than dictate it. Since Vietnam's current industrial capability is too weak to cope with intense global competition, Vietnam should increase and fully utilize FDI for its development. The government should also support local firms to link up with FDI firms which have extensive global networks. This has been the successful strategy in East Asia (including Thailand). As long as the policy is decided and owned by Vietnam, FDI-led growth will not mean the loss of economic autonomy.

The SME-led view, by contrast, considers that the main source of growth must come from the domestic private sector, not SOEs or FDI firms. While Vietnam's private sector still remains weak and small, it has shown strong growth since the new enterprise law of 2000. At present, SMEs continue to be suppressed due to unequal legal and policy frameworks. If such obstacles are removed and SMEs are given the "level playing field," they can become an endogenous growth engine.

The market-led view argues that the government should intervene as little as possible in order to let the market determine winners and losers in global competition. Policies implemented under political pressure and without sufficient information make the situation worse. While market solutions are often harsh, they are better than subsidies and protectionism. This view strongly supports privatization, trade liberalization and the minimal role of the government.

While these views may partly overlap in some cases, we can say that they point to fundamentally different strategic directions and are, in that sense, mutually exclusive. In the workshops and symposiums we have hosted, we have found that Vietnamese policy makers are often divided between the state-led view and the FDI-led view. The Japanese researchers and business community have strongly advocated the FDI-led view for Vietnam (this paper is also based on this view). However, there are also some Japanese

experts who support the SME-led view. The market-led view is sometimes presented by foreign experts but not seriously considered by Vietnamese policy makers.

The fact that the Vietnamese government remains ambiguous in its fundamental position, especially between the state-led view and the FDI-led view, creates a big problem for domestic and foreign investors alike. They are worried and uncertain whether the market principle will be strongly committed and promoted in the future or it may be modified or suspended at will in the name of “national interest.” Foreign manufacturers considering a relocation of their factories within East Asia are particularly sensitive to the reliability of the policy framework.

We urge the Vietnamese government to state its position on this matter unequivocally in the overall industrial master plan (and even in the next Five-Year Plan). My advice is to make an official statement including the following points:

- Vietnam is deeply and irreversibly committed to international integration and the market-oriented economy. The goal of industrialization and modernization will be achieved through improved competitiveness under these commitments, not through protection or subsidies.
- The Vietnamese government will play a crucial role in promoting industries as well as reducing various social costs associated with rapid industrialization and globalization. Such policies are necessary since Vietnam’s market economy is in the early stage of development. However, the ultimate fate of each industry shall be determined by global competition and the effort of each producer, not by the government.
- FDI will be strongly promoted as the main pillar of growth in the initial stage of industrialization (up to 2020). Creating a free and low-cost business climate for FDI attraction is a top national priority. At the same time, policies to help local firms link up with FDI firms and participate in the global market will also be implemented.
- SMEs are important because (i) they are the source of domestic growth and employment; (ii) they can become the basis of supporting industries; and (iii) some of them can even become globally competitive. Supporting measures toward these goals will be provided.
- SOEs will be selectively reformed in proper steps. SOEs which can become competitive through management reform and foreign linkage will be promoted. Other SOEs will be downsized, merged or closed while paying due attention to social impact. The speed of downward adjustment will be tuned to the speed of private and FDI sector development. The relative share of SOEs will be lowered through private sector development rather than a forced absolute reduction of the SOE sector (the two-track approach to SOE reform).

These are my suggestions only. The Vietnamese government should decide the appropriate contents of fundamental strategic direction by itself. Whatever the contents may be, however, there should be no ambiguity about the role of each economic sector.

4. Innovation in industrial strategy making

We propose the following shifts in the methodology of formulating industrial master plans, both for the overall economy and individual industries.

From quantity to quality (competitiveness)

Many of the existing master plans are expressed in desired quantities (output, export growth, local supply ratios, investment projects, etc) which in turn reflect certain policy goals of the top leaders. However, there is a significant gap between Vietnam's current capability and the severity of global competition. Any plan which disregards this fact can hardly be successful. In the age of globalization, industrial strategy needs to be formulated to create international competitiveness. This requires (i) thorough understanding of global and regional trends; (ii) competitiveness analysis of rival countries (particularly China and Thailand); and (iii) ascertaining Vietnam's current position; and (iv) designing realistic and concrete measures to raise Vietnam's competitiveness to the level of the target rival country (and beyond).

International competitiveness results from various factors. The physical quality of the product is of course crucial, but that alone is not enough. Consider the following aspects:

- *Cost factor*—for many producers, the largest cost component is parts and other intermediate inputs. Other important costs include electricity, land, water, telecommunications, transportation, housing, etc. Coping with bureaucratic harassment can also be very costly. Surprisingly, the wage level is not very important for many manufacturers. Its cost share is normally very small and its rise can be offset by productivity improvement.
- *Time factor*—quick response to market changes and customer requirement is the key to success. This includes not only short production time but also the time for design, transportation, customs clearance and final delivery to customers. Again, bureaucratic delays are highly detrimental to global business strategy.
- *Specialization and small lot production*—mass production of low-to-medium quality goods is easy, but it is invariably associated with excess supply and low profitability. Vietnam should aim at high-quality specialized products with small production lots which promise higher profit margin, rather than compete directly with Chinese mass produced goods. This is true in almost all products: electronics, garment, footwear, motorbike, seafood, furniture, handicraft, etc.
- *Choosing the right production model*—there are different production models in global competition: integrated vs. modular, vertical vs. horizontal, etc. Vietnam should select the production models which are most suitable for its dynamic comparative advantage (skilled labor-intensive manufacturing).

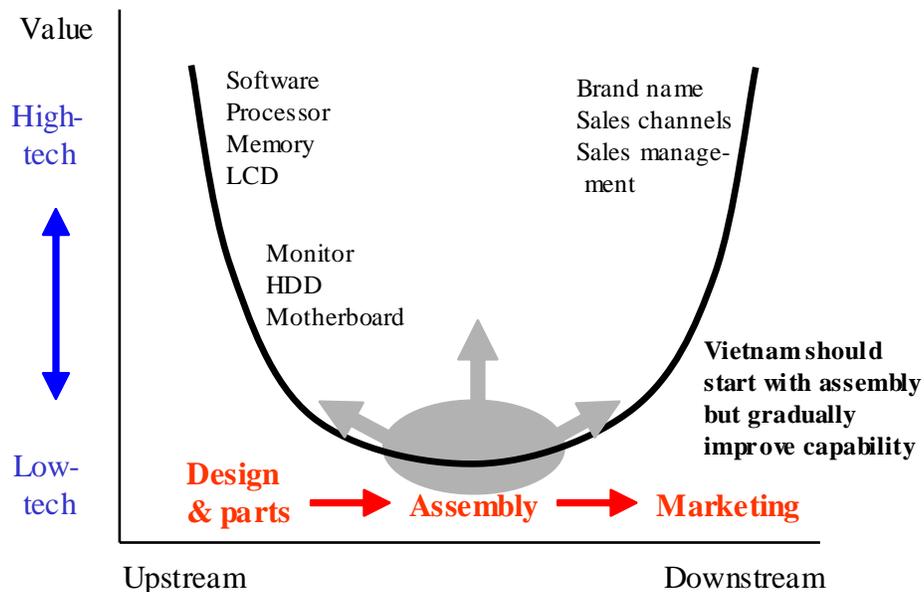
- *Marketing*—firms that can reach out to consumers and users can get better information and higher prices than those that don't. Vietnam currently lacks the ability to conduct effective international marketing.
- *After-purchase support*—for durable products, reliable after-purchase service also contributes to building good reputation and customer loyalty.

From product orientation to process orientation

The Vietnamese government encourages high-tech industries. Under extensive international division of labor, however, the concept of high-tech products is highly ambiguous. The popular notion that computer, DVD, digital camera, etc. are high-tech while garment, footwear, food, etc. are low-tech is misleading. When upstream and downstream processes of one product take place in different countries, some processes require high technology and creativity while other processes can be done by any country. Naturally, value-added is more often associated with high-tech processes, not with the entire product.

The diagram below shows where the value is typically created in computer production. Value is high at the beginning (design and parts) and the end (marketing) while the middle process (assembly) is fairly low-tech. In this sense, computer assembly is not much different from cutting and sewing garment. The most “high-tech” process I have witnessed in Vietnam was a frozen shrimp factory in Can Tho. To comply with hygienic standards for export, the factory must use state-of-the-art production management and equipment. The idea that computer is high-tech and shrimp is low-tech is seriously mistaken.

Value-Added in Computer Production



Source: Adopted from Yumiko Okamoto, "Electronics and Electrical Industries," in K. Ohno & N. Kawabata eds, *Industrial Strategy of Vietnam*, Nihon Hyoronsha, 2003, p.101 (Vietnamese translation in 2003, p.116)

Moreover, even low-tech processes can generate much value-added and profit if performed with skilled workers under excellent management. The difference between cheap garment of ordinary quality (men's white shirt) and expensive garment of high quality (ladies' fashion) is substantial. Vietnam should move from the former to the latter over time.

For these reasons, distinction between high-tech and low-tech products is not very meaningful. We need to think in terms of processes, not products. The important thing is to start with "easy" processes but gradually increase value by (i) performing the easy processes better than other developing countries (including China); and (ii) gradually expand to adjacent, more high-tech upstream and downstream processes of the same product. These correspond to vertical and horizontal gray arrows in the diagram above.

From picking individual industries to setting a broad direction

Industrial promotion requires a delicate balance between government and market. There is no doubt that the market should be the ultimate judge for the fate of any firm or industry. However, this does not mean that everything should be left to the market force. The government must support the burgeoning market while not obstructing its development. This is a very subtle task. The problem is particularly acute for a country like Vietnam with underdeveloped markets and insufficient policy capability.

There have been many studies on the competitiveness of Vietnamese industries. One popular method is to classify individual industries into competitive, somewhat competitive, and not competitive and so on, according to revealed comparative advantage (RCA), effective protection, labor content, qualitative judgment, etc. However, such categorization may not indicate true dynamic comparative advantage of Vietnam. First, these studies rely on past and present situations, not future possibility. Second, dynamic comparative advantage is not predetermined but can be created in some cases by appropriate policies. Third, industrial strategy should be formulated for *processes*, not for industries or products as argued above⁶.

The government should generally support production processes which are suitable for Vietnam without pre-judging specific industries. Which products and processes will emerge is up to market competition whose result is hard to predict even for international producers. The government has much less information than such producers. Its proper role is to indicate the general direction clearly without

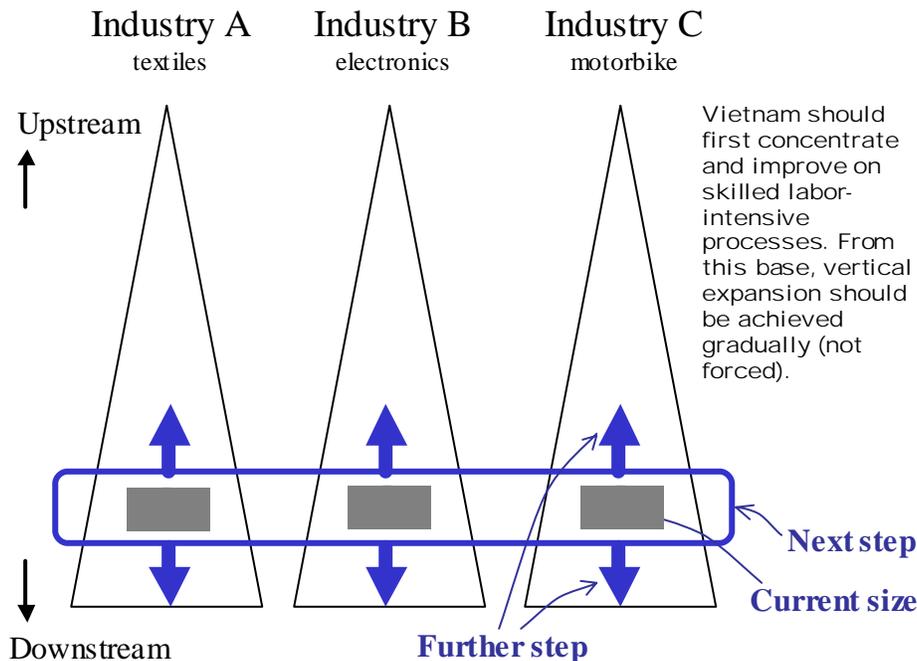
⁶ In some studies, for example, steel is classified as an "uncompetitive" industry. However, there are many products and processes within the steel industry. To say unconditionally that the entire steel industry is uncompetitive is, we think, a bit too crude. In long steel rolling (bars and wires) and galvanizing sheets, where required capital is relatively low, there is already excess supply in Vietnam. As to flat steel rolling, Vietnam is currently building its first cold rolling mill whose competitiveness will depend, among other things, on the production management capability and appropriateness of policies (including tariff rates).

micromanagement. Whenever individual industries are evaluated, the government should listen and follow or predict the market trend rather than imposing its own ideas on it.

5. Skilled labor-intensive manufacturing

Based on the arguments above, we believe the proper way to announce the direction of industrial promotion can be expressed in the following way:

“Vietnam’s dynamic comparative advantage in the next few decades lies in *skilled labor*-intensive manufacturing. Vietnam is endowed with high-quality labor force whose potential is second to none in East Asia. This human resource however is not yet fully utilized to meet the challenges of increased external competition. The government will prioritize and strongly support any production processes which take advantage of Vietnam’s skilled labor.”



“At present, Vietnam has already achieved some successes in the labor-intensive processes of the following industries: garment, footwear, seafood, electronics, furniture, and handicraft. The government will encourage expansion (horizontal) and increased value-added (vertical) of these processes. It will also support skilled labor-intensive processes in other industries (software, household tools, food processing, etc). These are the leading industries for Vietnam. Vietnam aims to be the top-class country in these areas by 2020.”

“At the same time, these leading industries require parallel developments of other industries that support them. The following ‘supporting industries’ in a broad

sense will also be promoted for the purpose of smooth and healthy industrialization:

--*Hard supporting industries* (parts and materials)

--*Soft supporting industries* (product design, global marketing and procurement, telecom, transportation, power, water supply, etc)

--*Industries to fulfill growing domestic demand* (steel, chemicals, plastic, paper, cement, etc. but with partial--not 100%--local supply and under careful evaluation of cost and competitiveness)”

6. Attracting a critical mass of FDI

FDI attraction is the most important task under the industrial strategy proposed in this paper. Vietnam’s FDI policy is improving but its speed is too slow to effectively respond to the rising global challenges including China, FTAs, WTO negotiation, etc. We urge a drastic improvement of FDI climate in order to make Vietnam the best FDI destination in East Asia (better than China and Thailand).

At present, there are mixed signals about FDI inflows into Vietnam. On the one hand, donors and business communities continue to complain bitterly about the inferior business climate. On the other hand, foreign firms (especially small ones) are beginning to show renewed interest in investing in Vietnam since 2003. The JETRO in HCMC reports a sharp increase in the inquiries and visits by Japanese enterprises in recent months. Should we be pessimistic or optimistic?

My view is that these periodic fluctuations should not worry the policy makers too much. FDI inflows are sometimes high and sometimes low, but the fundamental problem of Vietnam is that the base is too low anyway. It has not yet received a critical mass of FDI to ignite robust industrialization. Instead of worrying about small fluctuations, there should be a dramatic policy shift to realize a much higher average level of FDI in the medium to long term, perhaps five to ten times more than the current level of \$2-3 billion per year.

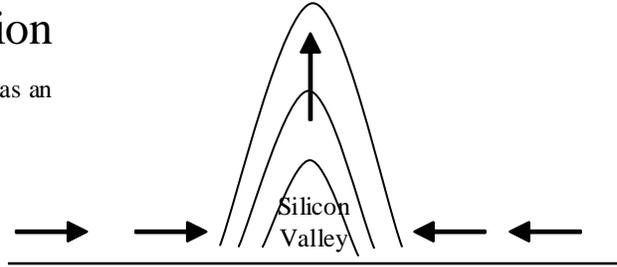
Thailand and Malaysia transformed themselves from primary commodity producers (rice, rubber, tin, etc) to global electronics exporters during the late 1980s, when they received strong inflows of electronics FDI on the order of 100 firms or more. As a consequence, their manufactured export ratios rose from 30-40% to 70-80%. Vietnam has not experienced such an event yet. If Vietnam wishes to become a world leader in any production process, it also needs to receive torrential FDI inflows for several years. It needs to attract not just small firms with isolated operation, but an entire group of large firms and their numerous suppliers. In other words, the “Canon effect” must be multiplied by many times to realize this transformation.

The dynamics of FDI in East Asia is highly complex. The two forces of *agglomeration* (concentration of a certain process in one location) and *fragmentation* (international division of labor among such concentrations) are at play. Furthermore, their interactive patterns differ from one industry to another. In this dynamic process, it is never too late to

join the game and attract new FDI. This is particularly so in the electronics industry where new products are created continuously. Vietnam's goal should be to become an important link in the agglomeration-fragmentation dynamics of East Asia.

Agglomeration

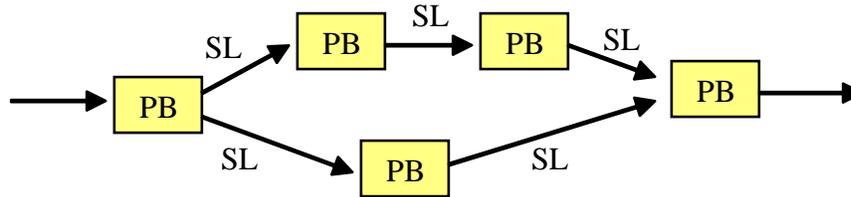
Initial concentration has an accelerating effect



Fragmentation

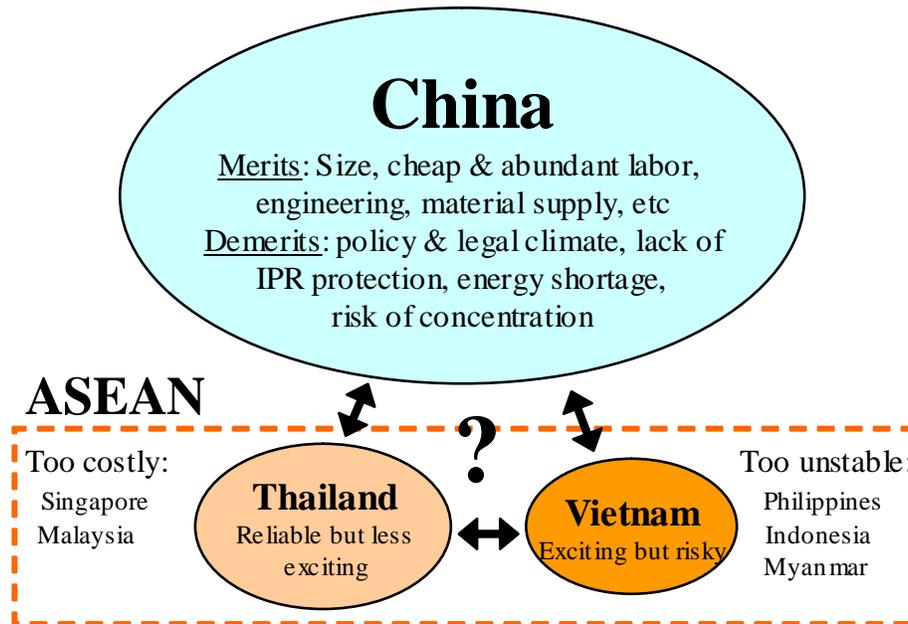
International division of labor in parts production & assembly

PB: production block
SL: service link



Moreover, MNCs are constantly in search of new locations that offer the lowest cost of doing business. They will happily shift their factories across countries in order to win global competition. Among Japanese manufacturers, China is undoubtedly the most favored FDI destination, but putting all eggs in one basket is risky. Many large firms are also considering new investments in ASEAN, and Thailand and Vietnam are currently two top candidates. Thailand is reliable but less dynamic. Vietnam is exciting but its FDI climate is inferior. By improving FDI climate, Vietnam can position itself above Thailand as the No.1 FDI host country in ASEAN. This consideration should be included in FDI policy formulation.

Japanese Firms: Choosing FDI Host Countries



No one expects Vietnam to become an investors' paradise overnight. However, investors need an assurance that Vietnam is keenly aware of its inferior investment climate and taking realistic steps to correct it as a top national priority. Therefore, the most important thing in attracting FDI is to send the right signal. Changing the image of Vietnam is more important than what Vietnam can actually do today. In this sense, it is a psychological game. Market psychology can be changed quickly even though roads and ports cannot be upgraded immediately.

My advice is to prioritize and sequence actions rather than trying to do everything at once. Specifically, I propose that Vietnam start with the following "easy" actions which require little capital investment but may have large announcement effects⁷:

- (1) Declare a national campaign to become the no.1 FDI host country in ASEAN
- (2) Concentrate authority for economic policy formulation
- (3) Mobilize foreign expertise more strategically
- (4) Execute the Vietnam-Japan Joint Initiative well
- (5) Create the Vietnam Investment Promotion Agency (VNIPA)
- (6) Create a few bright spots and advertise effectively, for example
 - Reduce industrial electricity tariffs to lowest levels in East Asia
 - Reduce telephone charges to lowest levels in East Asia
 - Create the fastest and cheapest internet environment in ASEAN
- (7) Policy debate on public utility charges (incl. possibilities to lower them)

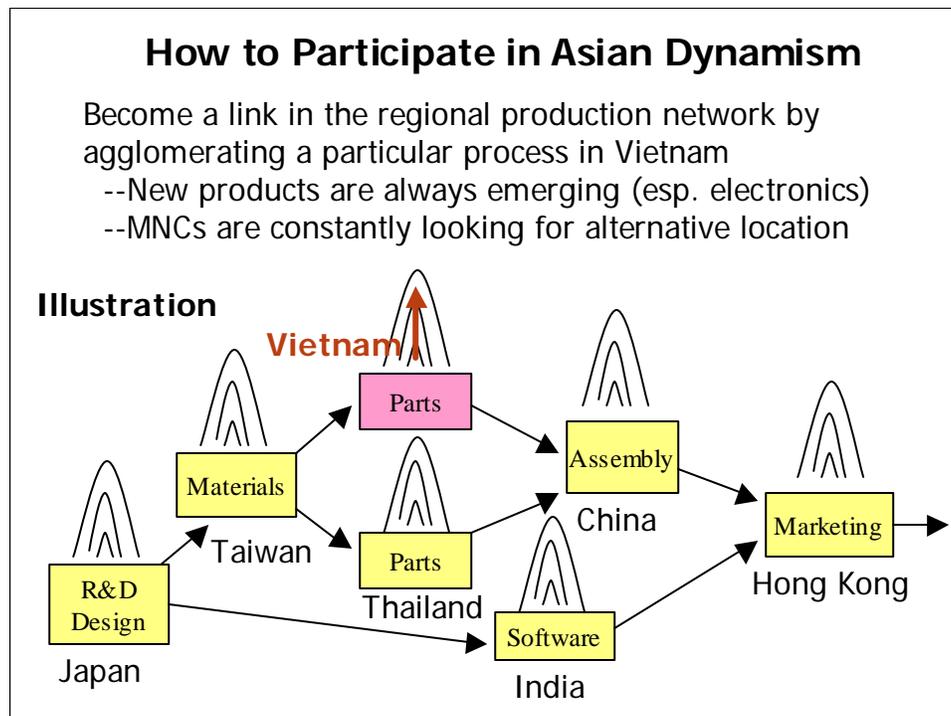
⁷ For details, please see my *Vietnam at the Crossroads*, VDF Policy Note no.1, December 2003.

In conducting these policies, MOI needs to cooperate closely with other economic ministries, especially MPI.

7. Building optimal regional linkages

On the one hand, there is an acute need to develop supporting industries so Vietnam does not have to rely heavily on imported inputs. On the other hand, globalization requires that countries should trade industrial goods with each other instead of trying to produce everything domestically. Do these statements conflict with each other?

The key to solve this “contradiction” is for Vietnam to become a crucial link in the East Asian production network by specializing in certain processes while importing other intermediate goods from neighboring countries. The goods Vietnam produces and exports must be those that take full advantage of its dynamic comparative advantage (i.e., skilled labor-intensive manufacturing) while the goods Vietnam imports must be those in which other countries have dynamic comparative advantage. When these goods are combined properly, the result will be the highest competitiveness in the global market. But if combined wrongly, the outcome will be disastrous. To survive and win tough global competition, it is essential to combine the best from each country.



For the goods in which Vietnam specializes, there should be sufficient agglomeration and a broad development of supporting industries. Supporting industries are needed in some industries only to strengthen Vietnam’s dynamic comparative advantage. For the goods in which Vietnam does not excel, there should be no encouragement of upstream investment since the money will be wasted. For example, Hong Kong offers a wide variety of textile materials at low cost. Vietnam should outsource textile materials from such international

textile centers and add high value in the production of garment, rather than investing public money to produce textiles. If private companies are investing in upstream production, it is they who will take the risk. But the government should not pour a huge amount of money for production the private sector considers inefficient.

China (especially Southern China) and the ASEAN neighbors are particularly important potential partners for Vietnam⁸. Geographically, Vietnam is ideally located to serve as a bridge between China and ASEAN. China is often regarded as a threat to Vietnam’s industrialization. This is partly true, but China’s role as Vietnam’s partner in international production should also be emphasized. China excels in producing industrial materials and inputs of low-to-medium quality at low cost. This advantage should be combined with Vietnam’s skilled labor to produce internationally competitive products.

What should be combined from which country? Determination of concrete combinations requires in-depth and up-to-date knowledge of each product. Moreover, the state of global competition is changing constantly. In formulating such a strategy, the government should listen carefully to the words of many international business people before deciding. Bureaucrats and professors are not the right persons to judge. In Japan’s industrialization process, the Ministry of International Trade and Industry (MITI) had extensive channels of information exchange with the business community during the 1960s.

8. Breaking the glass ceiling

This issue may be a bit too early to discuss in the context of Vietnam today, but I believe it is useful to have a longer-term vision as the medium-term strategy is formulated. Vietnam’s goal should not be just to catch up with Thailand but go beyond.

Depending on the achievement level in technical absorption, industrial countries can be classified into different types as shown below.

Type	Description	Countries
<Stage 1> Assembly only	Without supporting industries. Heavily dependent on foreign technology and management.	Vietnam
<Stage 2> Assembly and parts	With substantial supporting industries. Still heavily dependent on foreign technology and management.	Thailand, Malaysia, (China)
<Stage 3> High domestic capability	Technology and management are mostly internalized. Can produce high quality products but cannot lead innovation or product design.	Korea, Taiwan
<Stage 4> Full innovative	Equipped with all industrial capabilities, including innovation and product design in the frontline of technology.	Japan, US, EU

⁸ This point is frequently emphasized by the Japanese business community in Vietnam, including JETRO, the management of Thang Long Industrial Park, etc.

capability		
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The criteria for the classification are the existence of (i) supporting industries; (ii) capability in technology and management; and (iii) capability in frontline innovation, in the ascending order of difficulty.

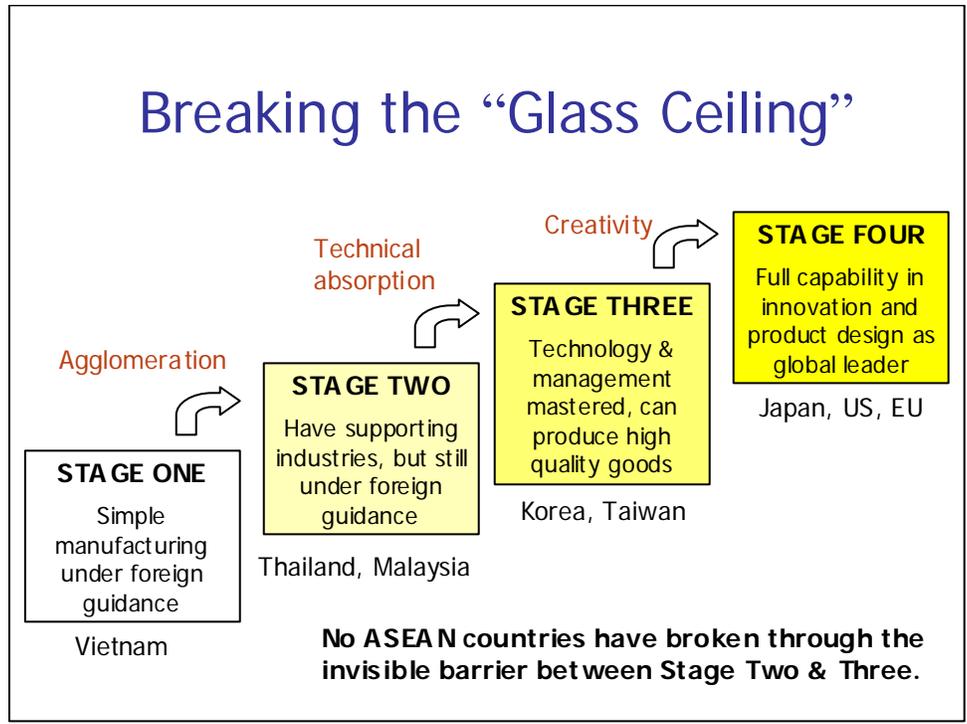
Industrialization of developing countries usually starts from Stage 1 where simple processes are established under foreign dominance. At this stage, most inputs are imported from abroad. In Stage 2, as domestic assembly reaches a critical mass, domestic supporting industries develop (by either local or foreign-invested suppliers). However, production is still highly dependent on foreign technology and management. In Stage 3, technology and management capability is internalized, and foreign dependency is significantly reduced. Finally, in Stage 4, capability to create new products and lead industrial development on a global scale is achieved.

Climbing up this ladder is extremely difficult for most developing countries. Even in East Asia where industrialization is said to be quite successful, only Taiwan and Korea have reached Stage 3. Within ASEAN, there is no country that has broken the barrier between Stage 2 and 3. It is as if there is an invisible glass ceiling preventing the ASEAN countries to go above that level. China may have the capability to internalize technology in the future, but its current exports are highly dependent on foreign technology and parts.

It is too early to tell whether Vietnam can overcome this glass ceiling. Vietnam is still in Stage 1 and the next goal is to climb up to Stage 2. But Vietnam has a long-term advantage which Thailand and other ASEAN countries lack, namely, highly skilled and diligent labor. If this advantage is combined with greatly improved policies and excellent management, Vietnam will be able to become the first country in ASEAN to reach Stage 3. While the goal now is to attract as much FDI as possible, Vietnam should also begin to accelerate technical absorption to prepare for the further stages of development⁹.

Internalization of technology and management will require patience and strong resolve. But Vietnam's industrialization strategy should not only fulfill short-to-medium run targets but also have high aspiration for the long run.

⁹ In my article, "The Lucky Country," *Vietnam Economic Times*, January 2004, pp.14-15, I argued that Vietnam's policy and business management must be improved dramatically to take advantage of its high-quality labor. The article is also reprinted under a different title in VDF Policy Note no.1, December 2003.



9. Suggested contents for the overall industrial vision

This paper presented a number of issues that should be considered in upgrading Vietnam’s industrial strategy. At the end of discourse, let us present a possible table of contents for an overall industrial vision¹⁰.

Part One: Analysis of the Current Situation	
1. Global review	<ul style="list-style-type: none"> --Global development and competition trends --Global economic conditions (Japan, US, EU, etc) --Trends in international trade: WTO, FTAs, etc. --Trends in FDI, ODA and other transfers and capital flows
2. Regional review	<ul style="list-style-type: none"> --Asian dynamism and regional production network at present --Assessment of Chinese industrialization --Assessment of ASEAN neighbors --Status of AFTA implementation (for all ASEAN countries) --FDI competition with China and other ASEAN countries --Regional FTA initiatives
3. Vietnam’s current position	<ul style="list-style-type: none"> --Industrial achievements under Doi Moi and globalization (past review) --Sources of current growth and its problems --Vietnam’s current position in East Asia’s production network

¹⁰ VDF will review the industrial strategy documents of other countries such as Malaysia, Thailand, Korea, Japan, etc. However, the reality of Vietnam today is different from the situation these countries faced in the past, especially in the intensity of international integration. While the experiences of other countries are useful, we need to add new policy elements to cope with the increased pressure of globalization.

	<p>and global competition (income, technology, industrial agglomeration, input supply, depth of international linkage, production cost comparison, engineers and managers, etc.)</p> <ul style="list-style-type: none"> --Vietnam as an FDI host: policy improvements, perception of foreign investors, remaining tasks --Assessment of trade commitments and their impact (AFTA, USBTA, WTO negotiation, regional FTAs, etc) --Vietnam's strengths and weaknesses compared with China or Thailand
Part Two: Industrial Strategy up to 2020	
4. Fundamental Strategy for industrialization	<p>(See Section 3 of this paper)</p> <ul style="list-style-type: none"> --Irreversibly committed to integration and market economy --Government will play an important supporting role --FDI attraction and local firm link up to FDI is main pillar --SMEs are also important for job creation, supplier base, etc. --SOE reform: two-track approach
5. Industrial goals for 2020	<p>(See Section 2 of this paper)</p> <ul style="list-style-type: none"> --Relative income (join the middle income group) --Export structure (manufactured products: 75% or more) --Boast a few leading export items with global competitiveness --Establish supporting industries ("hard" supporting industries) --Establish supporting services ("soft" supporting industries)
6. Leading industries and supporting industries	<p>(See Section 5 of this paper)</p> <ul style="list-style-type: none"> --Skilled labor-intensive manufacturing is the leading sector and maximization of its potentiality is highest national priority --Skilled labor intensive processes: garment, footwear, electronics, furniture, handicraft, and others --Promotion of hard supporting industries --Promotion of soft supporting industries --Promotion of industries to fulfill growing domestic demand
7. Reform of industrial policy formulation	<p>(See Section 4 of this paper)</p> <ul style="list-style-type: none"> --From quantity to international competitiveness --From product orientation to process orientation --From picking individual industries to setting a broad direction --Administrative reform within government (better vertical and horizontal coordination)
8. Linking industrial policy with trade policy	<ul style="list-style-type: none"> --AFTA tariffs, non-AFTA tariffs and WTO tariff offers --Policy on non-tariff measures, market access and other areas --Linkage between above measures and MOI's industrial master plans
9. FDI attraction and promoting parts suppliers	<p>(See Section 6 of this paper)</p> <ul style="list-style-type: none"> --Proper FDI targets in light of East Asian FDI dynamics and Vietnam's dynamic comparative advantage --Critical mass of FDI to ignite autonomous industrialization and build supporting industries --Immediate actions and long-term improvements needed

10. Optimal regional linkage	(See Section 7 of this paper) --Creating agglomeration of skilled labor-intensive parts in Vietnam for export (with its supporting industries) --Outsource other inputs from China and the rest of ASEAN
11. Technical transfer and improving domestic capability	(See Section 8 of this paper) --Measures to supply managers, engineers and professionals --Reform of higher education and studying abroad --Use of ODA technical assistance and FDI linkage
12. Interim roadmap	--Up to 2005 (income, export structure, FDI, localization, etc) --Up to 2010 (same)
Note: This is the proposed contents of an overall industrial master plan. Master plans for individual key industries must also be drafted separately.	

This table follows the standard format of industrial strategy papers compiled by many Japanese economists, except that greater attention is given to the aspects of globalization that Vietnam faces.