Avoiding the Middle Income Trap:
Renovating Industrial Policy Formulation in Viet Nam

Kenichi Ohno (VDF/GRIPS)
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- Proactive industrial policy
- Common policy menu for enhancing industrial capability
- Malaysia's "New Economic Model"
- Recommended actions for Viet Nam
What Is a Middle Income Trap?

- A developmental trap occurs when a country is stuck at the income dictated by given resources and initial advantages, and cannot rise beyond that level (only luck and no effort).
- The level of income where the trap may occur depends on endowment of resources and advantages.
  - Low endowment ➔ Poverty trap
  - Moderate endowment ➔ Middle income trap
  - High endowment ➔ High income

Middle Income Trap (cont.)

- Many countries can reach middle income by liberalization and integration, but reaching higher income requires strong policy effort to stimulate private dynamism.
- Growth based on FDI, big projects, natural resources, or locational advantages will eventually end. The true source of development is value creation by humans (knowledge, skills, technology).
- Policies and institutions must promote human capital formation. Such policies are possible even under globalization, but they are different from past policies. I call it “proactive industrial policy.”
Speed of Catching Up: East Asia

Per capita real income relative to US
(Measured by the 1990 international Geary-Khamis dollars)


Latin America

Per capita real income relative to US
(Measured by the 1990 international Geary-Khamis dollars)

South Asia

Per capita real income relative to US
(Measured by the 1990 international Geary-Khamis dollars)

Africa

Per capita real income relative to US
(Measured by the 1990 international Geary-Khamis dollars)

Per capita real income relative to US
(Measured by the 1990 international Geary-Khamis dollars)


Stages of Catching-up Industrialization

Pre-industrialization
Initial FDI absorption
Internalizing parts and components
Internalizing skills and technology
Internalizing innovation
Creativity

Arrival of manufacturing FDI
Agglomeration (acceleration of FDI)

STAGE ONE
Simple manufacturing under foreign guidance
Viet Nam

STAGE TWO
Have supporting industries, but still under foreign guidance
Thailand, Malaysia

STAGE THREE
Management & technology mastered, can produce high quality goods
Rep. of Korea, Taipei, China

STAGE FOUR
Full capability in innovation and product design as global leader
Japan, US, EU

Glass ceiling for ASEAN countries (Middle Income Trap)
Viet Nam’s Challenge

- Thanks to Doi Moi and large inflows of FDI and ODA, Viet Nam has reached lower middle income (pc GDP of $1,200 in 2010). But policies to upgrade human capital are not yet established.
- Viet Nam does simple assembly with unskilled labor. FDI will leave and de-industrialization will occur as wages rise and integration deepens. Without domestic value creation, Viet Nam will surely face a middle income trap.

Proactive Industrial Policy:
Seven Required Features

1. Strong commitment to global integration and private sector driven growth
2. A wise and strong government guiding private sector
3. Securing sufficient policy tools for latecomer industrialization
4. Constant policy learning through concrete projects and programs
5. Internalization of knowledge, skills and technology as a national goal
6. Effective public private partnership
7. Collection and sharing of sufficient industrial information between government and businesses
Proactive Industrial Policy (cont.)

- Infant industry promotion by tariffs and export subsidies is no longer allowed today.
- PIP strikes a balance between state and market, and is consistent with globalization. But it requires policy learning.
- PIP is already practiced widely, especially in East Asia. Systematic analysis of concrete PIP measures is needed.
- There is a standard policy menu for enhancing industrial capability. But selectivity and adjustment are required to adapt to the unique features of each country.

Standard Policy Menu for Enhancing Industrial Capability

<table>
<thead>
<tr>
<th>Framework</th>
<th>Policy content &amp; policy organization</th>
</tr>
</thead>
<tbody>
<tr>
<td>Vision-Plan-Action</td>
<td>Ministries &amp; agencies</td>
</tr>
</tbody>
</table>

**Enhancing industrial human and enterprise capability**

<table>
<thead>
<tr>
<th>Software</th>
<th>Policy framework</th>
<th>Finance</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Human capital</td>
<td>FDI/cluster policy</td>
</tr>
<tr>
<td></td>
<td>Enterprise support</td>
<td>Business linkage</td>
</tr>
</tbody>
</table>

**Innovation**

**Hardware**

**Application (hard+soft)**

**Infrastructure (power, transport/logistics)**

**Comprehensive regional development**
# Enhancing Industrial Human and Enterprise Capability: Standard Menu

<table>
<thead>
<tr>
<th>Main objectives</th>
<th>Sub items</th>
</tr>
</thead>
</table>
| **(1) Legal and policy frameworks** | Laws and regulations  
Ministries/agencies for promoting SMEs, FDI, etc. with sufficient capability and authority  
Inter-ministerial coordination mechanisms  
Effective public-private partnership (PPP)  
Mechanism for business-government-academia linkage  
Policy system consisting of visions, roadmaps, action plans, and monitoring  
Standards for quality, safety, skills, environment, etc.  
Mechanisms for protecting and utilizing intellectual property rights  
Strengthening of industrial statistics  
Strategic mobilization of international cooperation |
| **(2) Local capacity building** | Universities of technology and engineering, industrial colleges  
Short-term courses for entrepreneurs  
Technical support on specialized skills for engineers  
Technical and vocational training for new or current workers  
Skill certification, competition, and awards  
Subsidies and incentives for targeted activities (worker training, technology transfer, die and mold, marketing, ITC, etc)  
Management or technical advisory service (by visiting consultants, short-term)  
Enterprise evaluation and advice system (institutionalized shindan system or technical extension services) - also related to SME finance  
Local enterprise networks |
| **(3) Finance** | Development financial institutions  
Subsidized commercial bank loans for targeted firms (two-step loans)  
Credit guarantee system  
Equipment leasing  
Venture capital  
Enterprise credit information system  
Enterprise evaluation and advice system (same as in (2)) |
| **(4) FDI marketing** | List of priority products and activities and a system of investment incentives  
Investment promotion seminars and missions  
Effective investor information package and website  
Investment promotion offices abroad  
One-stop services and enterprise support (before and after investment)  
Upgrading infrastructure service quality (power, transport, water, etc)  
Environmental control and facilities (incl. waste water treatment)  
Industrial estates with sufficient infrastructure services and administrative services (incl. specialized industrial parks)  
Labor support (training, recruiting & matching, housing/dormitories, commuting, health care, etc)  
Prioritized and targeted FDI marketing  
Inviting individual target company (‘anchor firm’) and provision of required conditions |
| **(5) Linkage (learning by working with global standard firms; market development)** | Trade fairs and reverse trade fairs  
Enterprise databases (SMEs, supporting industries, sectoral)  
Official intermediation/promotion of subcontracting  
Incentives/subsidies for FDI-local firm linkage  
Domestic and export market development support  
Establishment and enhancement of industry associations |

(Cont.)
### Thailand: Supporting Industry Master Plan 1995

<table>
<thead>
<tr>
<th>Proposed program</th>
<th>Outcome</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>3. Technology upgrading</strong>&lt;br&gt;3.1. Technology extension service program (shindanshi sys.)&lt;br&gt;3.2. Expansion of occupational skill standard system&lt;br&gt;3.3. Public technical center activation program&lt;br&gt;3.4. Joint industry-university training schools</td>
<td>3.&lt;br&gt;3.1. (no action)&lt;br&gt;3.2. (no action)&lt;br&gt;3.3. TAI, TGI, etc.&lt;br&gt;3.4. TNI, TGI, etc.</td>
</tr>
<tr>
<td><strong>4. Financial support</strong>&lt;br&gt;4.1. Improvement of SME financing schemes&lt;br&gt;4.2. Assistance for SME in machinery leasing</td>
<td>4.&lt;br&gt;4.1. SME Bank, loan agent network&lt;br&gt;4.2. Credit guarantee, machine fund</td>
</tr>
<tr>
<td><strong>5. Upgrading of management</strong>&lt;br&gt;5.1. Entrepreneur re-education program&lt;br&gt;5.2. Continuation of technopreneur development project</td>
<td>5.&lt;br&gt;5.1. TNI, TGI, etc.&lt;br&gt;5.2. n.a.</td>
</tr>
</tbody>
</table>

### Viet Nam’s Supporting Industry Action Plan Proposed by Japan (June 2009)

- Viet Nam's action and Japan's support are specified in parallel.

<table>
<thead>
<tr>
<th>Policy framework</th>
<th>Definitions of SI, award system, inter-ministerial mechanism, SME laws, etc.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Human resource</td>
<td>Pilot TVET projects for engineers &amp; managers, skill certification system, monozukuri university, etc.</td>
</tr>
<tr>
<td>Finance</td>
<td>Low-interest loans, subsidies, tax exemption, shindan system, etc.</td>
</tr>
<tr>
<td>FDI marketing</td>
<td>Investment seminars, SI industrial parks, linkage between FDI and locals, etc.</td>
</tr>
<tr>
<td>Business linkage</td>
<td>SI database, trade fairs, industry associations, etc.</td>
</tr>
</tbody>
</table>
Malaysia’s “New Economic Model”  
(Announced in March 2010)

- “We are caught in a middle income trap; we are not amongst the top performing global economies.” (pp.3-4)
- Malaysia’s vision for 2020—(i) market-led, (ii) well-governed, (iii) regionally integrated, (iv) entrepreneurial, (v) innovative
- Three Goals
  - High income ($15,000-20,000)
  - Inclusiveness (everyone benefits)
  - Sustainability (fiscal, environmental)

<table>
<thead>
<tr>
<th>Malaysia’s Old and New Approach</th>
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</thead>
<tbody>
<tr>
<td><strong>Old approach</strong></td>
</tr>
<tr>
<td>Growth primarily through capital accumulation</td>
</tr>
<tr>
<td>Dominant state participation in the economy</td>
</tr>
<tr>
<td>Centralized strategic planning</td>
</tr>
<tr>
<td>Balanced regional growth</td>
</tr>
<tr>
<td>Favor specific industries and firms</td>
</tr>
<tr>
<td>Export dependence on US, EU and Japanese markets</td>
</tr>
<tr>
<td>Restrictions on foreign skilled workers</td>
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</tbody>
</table>

Strengths and Weaknesses of the Malaysian Approach

- Competent leader (PM), technocrats (EPU and others), and officials.
- Clear vision, goals, and policy direction.

**BUT**

- Issues and policy measures are too many and too broad – selectivity is required due to human and financial constraints.
- For Malaysia, the critical problem is lack of private sector response to good policies. Improving policies further will not solve this problem.
**Recommended Actions for Viet Nam**

1. Collect and study international best practices in chosen strategies (as building blocks of policies suitable for Viet Nam with selectivity & modification, not for random or blind copying)
2. Identify a small number of priority issues for *Industrialization and Modernization* by 2020 (up to several)
3. Adopt policy making procedure which is strategic and participatory
4. Create policy organization to realize such policy procedure for priority issues
5. Progress review by highest level

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**Study International Experiences**

For example, Viet Nam can study:

1. Engineering education and training at TPA, Thai-Nichi Institute of Technology, King Mongkut University, Thai-German Institute (Thailand), Nanyang Polytechnic (Singapore)
2. Quality and productivity policies of SPRING (Singapore) and MPC (Malaysia)
3. National SME Development Council of Malaysia
4. Automotive Institute and Automotive Industry Association of Thailand
5. FDI and business linkage policies of Malaysia and Thailand
6. Die and mold industry promotion in Indonesia
7. SME diagnosis and advisory (*shindan*) system of Japan
(2) Select Priority Issues for Action

Possible issues include:
1. Promoting engineering education with a roadmap and numerical targets
2. Revamping SME policy
3. Strengthening supporting industries
4. Transport and logistic efficiency
5. Agro and marine product exports with globally highest quality and safety
6. Comprehensive regional development based on industrial clusters

(Note: promotion of high-tech or global value chain may be too general for Viet Nam.)

(3) Adopt Policy Making Procedure which is Strategic and Participatory

1. Clear vision given by top leader
2. Consensus building (broad goals & directions)
   - Brainstorming by related ministries & agencies
   - Collection & analysis of international best practices
   - Discussion with non-government stakeholders
3. Documentation
   - Drafters can be officials, academics, or consultants
   - Participation of all stakeholders in drafting and commenting

Viet Nam is weak in all these steps.
1. Vision

Brainstorming
Studies & surveys
Stakeholder consultation

1. Participation

2. Consensus building process

Set broad goals & direction

2. Participation

3. Documentation process

Drafting work
Comments & revisions
Finalize & approve

3. Participation

Ministries & agencies
Businesses
Academics & consultants
Regions & localities

Note: the entire process is coordinated by a lead ministry or agency.

Viet Nam: Traditional M/P Drafting Process

Prime Minister
Minister
Drafting Team

Review for approval
Order
Submit

MPI & other Ministries
Internal review

Inter-ministerial review

No permanent channel for continuous policy dialogue (case-by-case, temporary, ad hoc)

Business Community

Data

MPI & other Ministries

International experts

Technical assistance (sometimes)

Interviews, symposiums (sometimes)

Contact Ministry when necessary

Appeal letter to Prime Minister when problems arise
(3) Create a New Mechanism to Realize Proper Policy Procedure

Different ways to design & execute policies:
- Semi-permanent technocrat group directly under PM to make key policies
- National council/committee headed by PM or DPM (up to a few in number)
- A super-ministry approach (eg. Japanese MITI in 1960s)
- Specialized “institute” or “center” to serve as a policy hub (eg. Thai auto policy)

Note: drafting master plans within each ministry without involving gov’t and non-gov’t stakeholders, as currently done in Viet Nam, cannot ensure implementability.

Technocrat Group Approach

- Elite technocrat group with full planning authority given by top leader
- Members are selected officials, business leaders & experts with good education & experience

Prime Minister

Direction, full authority for policy making

Faithful execution and reporting

Technocrat Group (Policy Maker)

Policy, guidance and monitoring

Faithful execution and reporting

Businesses Academics Experts

Ministries (Policy Implementers)

Rep. of Korea – Econ. Planning Board
Malaysia – Econ. Planning Unit
Thailand – NESDB
Taipei, China – Kuomintang Elites
Indonesia – “Berkeley Mafia”
Chile – “Chicago Boys”
National Council/Committee Approach

Typical configuration:

PM or President

Chair, give mandate

National Council or Committee

Support

working groups or task forces for specific issues and sectors

Ministries and agencies

Implement

Businesses
Academics
Experts

Plan

Comparing the Two Approaches

<table>
<thead>
<tr>
<th></th>
<th>Technocrat group serving top leader</th>
<th>National councils/committees</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Number</strong></td>
<td>Only one</td>
<td>Up to several</td>
</tr>
<tr>
<td><strong>Tasks</strong></td>
<td>Multiple and variable</td>
<td>Single task</td>
</tr>
<tr>
<td><strong>Time scope</strong></td>
<td>Semi-permanent (until this system is no longer needed)</td>
<td>Temporary (until the assigned task is completed)</td>
</tr>
<tr>
<td><strong>Relation with ministries</strong></td>
<td>A planning body above all ministries; the latter are implementing bodies</td>
<td>Ministers and officials participate in policy making as members</td>
</tr>
<tr>
<td><strong>Comment on Viet Nam</strong></td>
<td>Previously, PM’s Research Commission played an advisory role without policy making authority.</td>
<td>There are too many committees. Selectivity and strategic action-orientation are missing.</td>
</tr>
</tbody>
</table>
Michael Porter’s Proposal for Viet Nam

My Proposal for National Competitiveness Council

Prime Minister

Direct, give mandate

National Competitiveness Council

Commission studies, reports

Support, report, draft

Working groups for specific issues or sectors

SMEs
Secretariat: MPI
Ministries, businesses, experts

Supporting industries

Clusters
Secretariat: MOIT
Ministries, businesses, experts

TVET
Secretariat: MOLISA
Ministries, businesses, experts

Higher Educ.
Secretariat: MOET
Ministries, businesses, experts

Ministries and agencies

Note: This is a preliminary idea of K. Ohno to initiate discussion; listed issues and ministries are suggestions only; everything is subject to addition, deletion or change.
(5) Monitoring by Top Leader

- Top leader must be personally committed to priority policies and use his/her authority to push and publicize them.
- Progress should be regularly reported to the leader (monthly or quarterly official meetings).
- When a problem is identified, the leader should assign relevant minister for immediate action and result reporting.

Selected References


