

Walk don't run

Professor Kenichi Ohno from Japan's National Graduate Institute for Policy Studies has been a frequent visitor since 1994 researching Vietnam's industries as part of a project funded by Japan International Co-operation Agency. In this interview with VET he warns against Vietnam trying to do too much too soon and in the wrong places

From your experience what must Vietnam do and not do if it's to become successfully industrialised?

What you should do is to try to understand the dynamics of foreign direct investment and investors' motives. What you should not do is try to use your domestic resources.

But Vietnam has stated clearly its reliance on internal strength in its development process, and now you are advising against that approach?

If you mean human resources, okay, but if you are talking about natural resources such as iron, gas or coal, I think Vietnam should only use them if they are the cheapest and the highest quality in the world. In the globalisation age it's very difficult to maintain competitiveness by trying to maximise the utilisation of local natural resources because there are other producers who have the best resources in the world. You can buy better iron, for instance, from other countries and by doing so you can be competitive.

Is Vietnam already moving in that direction?

For fertiliser, textiles, electronics and steel - the main industries that we research - Vietnam wants a vertically-integrated process which means it wants to go 'upstream'. That is, into the production of input materials so it doesn't have to import so much. That policy is good in the long run, but creating upstream industries should not be forced. It should be done in a natural and gradual way in response to industrial needs. At the moment I think you should maximise your human capital, something which is not being done now. Go into areas where you have high potentiality which are skill and human resource-based industries rather than capital-based ones.

Could you please be more specific for each industry?

In the garment and textiles sector Vietnam currently focuses on cut-make-trim contracts where cloth is provided by foreigners. This produces little added value but it's okay for now. If you want to increase value-adding vertically by investing in the production of cloth I think you will lose money. Instead of

investing in new machines in the upstream you'd better to invest in information networks and try to improve workers' productivity.

Marketing also need to be improved. Working with foreign partners you can step by step learn about the overseas market, design and procurement. These things do not require huge capital investment but require human capital. If you do this your capacity will be improved and you can go into production of materials by 2030 or 2040.

With regard to fertiliser production, an appropriate factory should produce 570,000 tonnes a year. That requires an investment of \$240-400m which takes between 10-20 years to return. That's too costly at the moment. And there are also management constraints. If you do that now I don't think you can properly manage the factory and Vietnam's limited capital will be wasted. It should be begun possibly by 2020 when the demand for fertiliser is sufficiently large and your capability in terms of capital, technology and management is higher.

In steel sector there's currently a heated debate in the government as to the desirability of constructing a large-scale integrated steelworks. However, even if the decision is made now, actual construction will be much later and the required investment is nowhere in sight. Instead of wasting time on debating a gigantic project like that, Vietnam should focus on more urgent issues like operating its first cold rolling mill and dealing with the existing over capacity in long steel products. That way it can learn how to operate and maintain a modern mill. Time is also needed to learn about customer response, demand forecasts, tariff design, and response to international shocks. If Vietnam succeeds it will be able to proceed to the next step which is to build a hot strip mill. But if it fails, there will be no future for Vietnam's steel industry.

As for electronics, assembling, putting things together, is appropriate at the moment. I do not think Vietnam can jump into high-value added activity just now. Electronics manufacturing requires very high-tech. At the moment only places like Japan, Europe, America, Korea and Taiwan can produce materials and parts. I don't think Vietnam should aim at high-tech now. That does not mean it will not be able to catch up in the long run, in fact that is the only way to catch up. Work with foreign partners, learn from their management and technology, and accumulate capital. I understand why Vietnam wants to go into high-tech but the gap between your hopes and your capability is so huge that if you jump straight in you will never get there. You should bear in mind that it took Japan 50 years to go from light industry to heavy industry, and I do not think Vietnam can go that fast. The step-by-step, long and roundabout way is the right way.

What do mean by "dynamics" and motives? What role can foreign direct investment play in the process of industrialisation?

The most important strategy for achieving industrialisation by 2020 should be the attraction of more

foreign direct investment (FDI). The experience of Asean shows that export-oriented FDI is the main engine in a country like Vietnam for its first few decades of industrialisation and integration.

There has been a large amount of FDI into Vietnam, an amount which we see in very few countries. But Vietnam's policies have always lagged behind investment trends. The FDI success is mainly because Vietnam opened up when there was a boom in FDI. Things have changed now, however.

Investors' decisions on where to locate their factories are driven by two opposing forces; agglomeration and fragmentation. Agglomeration means a whole industry concentrates in one place, such as the computer industry in Taiwan. Fragmentation means the different processes of one industry are carried out in different places. If Vietnam want to get FDI it must understand the dynamics of these forces rather than coming up with five or ten year investment plans. Dialogues with investors are useful but it is even more important to understand why other investors do not come to Vietnam. The problem is that the interaction of forces vary from one product, process and part to another. They also change very quickly so you have to listen to businessmen and get a lot of information.

What is the biggest obstacle for Vietnam in attracting FDI?

I think Vietnam's foreign investment laws already offers enough incentives to investors and there is no need to offer even more. Interviews with Japanese firms clearly indicate that the lack of financial incentives such as tax break is also not a problem, and offering more of them is unlikely to attract more investment. Vietnam is losing potential investors to China, Thailand and other countries mainly due to a perceived policy uncertainty. Compared with its neighbours, Vietnam's policy environment is hardly fair or predictable, though it's improving.

Inconsistency between trade and competition policies in Vietnam is a boon to opportunistic investors with pre-modern technology and management. These investors come to take advantage of the government's protection and customers' limited awareness of deficient quality. They have low quality, limited investment in technology and human resources and a short time horizon.

How can we improve this?

In other Asean countries and also in Japan in the early stage of economic development, there was a powerful elite group guiding overall economic policies. All ministries and agencies worked under the guidance of this elite group. The result was powerful, flexible and consistent policy making. I think Vietnam should imitate this. Otherwise you cannot integrate trade, competition and industrial policies.

Vietnam's authority over economic policy is too diffuse at the moment, causing delays and inconsistencies. We talk to the ministries of Trade and Industry and they say different things. The Ministry of Trade says the tariff on a certain product will be reduced, but when we go to the Ministry of

Industry they say they will continue to protect that product. This decentralised policy making sends ambiguous signals to investors and international organisations and is very bad for attracting FDI.

Do you have any other advice regarding FDI?

Foreign investors will bring in markets, input and job opportunities immediately, but technology transfer takes time. Both sides should be patient. Supporting industries must also be realised in proper time and sequence. Hasty requirement of local content ratios not only violates WTO rules but also scares away investors.

At present I think Vietnam should try to attract as many assembly-type projects as possible, without being too selective about sectors. Then as assembly-type factories desire to procure inputs domestically, you proceed to invite domestic and foreign parts manufacturers. Technology transfer and research and development (R&D) will come after this. You also need to have different policies for export and domestically-oriented FDI because they have different characters.

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