

The Automobile Industry in Vietnam

Remaining Issues in Implementing the Master Plan*

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The strategy of the automobile industry and the master plan of the automobile industry were approved by the prime minister in December 2002 and October 2004, respectively¹. In order to implement these decisions effectively, the Vietnamese government must identify and solve a number of problems in the months ahead. This paper evaluates the current master plan in Part I and raises several remaining issues that should be considered in implementing and revising the master plan in the future in Part II.

Part I. Assessing the Master Plan

The recently approved master plan of the automobile industry has seven sections. The first section states the government's perspective while the second presents both overall and detailed targets. The third and fourth sections contain the orientation of the industry up to 2010 and required investment projects. The fifth section discusses the financial sources and the sixth specifies supporting policies. The final section allocates responsibilities to various organizations.

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¹ It is customary that, for any industry, a short *strategy* (chiến lược) giving general direction is approved first, followed by a more detailed *master plan* (quy hoạch).

1. Numerical targets

The objective of the master plan is to assist Vietnam's automobile industry to become an *important industry*² by 2020. Numerical production objectives are indicated, for example:

Table 1. Forecasts of Automobile Output up to 2020

(Unit: number of vehicles)

	2005	2010	2020
Cars	35,000	70,000	144,000
Up to 5-seat car	32,000	60,000	116,000
6-9 seat car	3,000	10,000	28,000
Coaches	15,000	36,000	79,900
10-16 seat	9,000	21,000	44,000
17-25 seat	2,000	5,000	11,200
26-46 seat	2,400	6,000	15,180
> 46 seat	1,600	4,000	9,520
Trucks	68,000	127,000	159,800
Up to 2 tons	40,000	57,000	50,000
2-7 tons	14,000	35,000	53,700
7-20 tons	13,600	34,000	52,900
> 20 tons	400	1,000	3,200
Specialized vehicles	2,000	6,000	14,400
TOTAL	120,000	239,000	398,000

Source: Compiled from the *Decision 177/2004/QĐ-TTG approved the Master Plan for Developing Vietnam's Automobile Industry*, Oct. 2004.

These numbers are taken from the projection in the master plan of land transportation for 2010 and up to 2020 which was prepared by the Ministry of Transport and already approved by the government.

In addition to output targets, the master plan also features localization, exports and required investment. Targeted localization ratios in 2010 for popular vehicles (trucks, coaches and cars), high-class vehicles (trucks, coaches and cars), and specialized vehicles are 60%,

² The Vietnamese government distinguishes *leading industries* (công nghiệp mũi nhọn), *important industries* (CN quan trọng), and major industries (CN chủ yếu). However, the definitions and the criteria for the selection of these industries are not clearly known to the authors. There does not seem to be any consensus on them even among policy makers, either.

40-45%, and 60%, respectively³. The exports of automobiles and automobile parts and accessories should be 5-10% of the total output of the industry in 2010. Between 2003 and 2010, additionally required investment in production capacity has also been specified for each type of vehicle, as below.

Table 2. Existing and Required Production Capacity up to 2010

(Unit: vehicle per year)

	Production capacity in 2003	Demand forecast for 2010	Additionally required investment
Cars			
Up to 5 seat car	>100,000	60,000	Not needed
6-9 seat car	4,000	10,000	6,000
Coaches			
10-16 seat	--	21,000	21,000
17-25 seat	--	5,000	5,000
26-46 seat	7,000	6,000	Not needed
> 46 seat	2,000	4,000	2,000
Trucks			
up to 2 tons	10,000	57,000	47,000
2-7 tons	4,000	35,000	31,000
7-20 tons	--	34,000	34,000
> 20 tons	--	1,000	1,000
Specialized vehicles	300	6,000	6,000

Source: Compiled from the *Decision 177/2004/QĐ-TTG approved the Master Plan for Developing Vietnam's Automobile Industry*, Oct. 2004.

2. How to achieve the targets

In order to achieve these targets, the master plan specifies the location of investment, industrial standards, and the roles of foreign invested enterprises (FIEs) and state-owned enterprises (SOEs).

³ It must be noted that trucks, coaches (buses) and cars, which are put together for each category here, face different levels of difficulty in achieving these localization targets. Generally speaking, it is far more difficult to raise the localization ratio of passenger cars than that of trucks or coaches.

Investment is encouraged to take place in the Hanoi-Hai Phong-Quang Ninh corridor in the North, from Thanh Hoa to Khanh Hoa in the Central, the HCMC-Ba Ria Vung Tau- Dong Nai-Binh Duong area in the South, and Can Tho in the Mekong River Delta. All projects are required to follow the “standard sets on automobile assemblers and manufacturers.” New projects must have advanced technology from large automobile manufacturers in the world. FIEs must follow their investment licenses. FIEs are also encouraged to manufacture engines and engine parts.

It is particularly noteworthy that the master plan designates four SOEs and two ministries to be the leading players in selected products and processes as shown in Table 3.

Table 3. Production Assignment for SOEs and Ministries

Entity	Assigned role
Vietnam Auto Industry Corporation	Manufacture and assemble coaches, small and medium trucks, cars, engines, gearboxes and movers
Vietnam Engine and Agricultural Machinery Corporation	Manufacture and assemble coaches, small and medium trucks, engines, gearboxes and movers
Vietnam National Coal Corporation	Manufacture and assemble medium and heavy trucks, specialized vehicles and their parts and accessories
Saigon Automobile Mechanical Corporation	Manufacture and assemble coaches, specialized vehicles and some automobile parts
Ministry of Police and Ministry of Defense	Manufacture and assemble technical and tactical vehicles for national security purposes

Source: Compiled from the *Decision 177/2004/QĐ-TTG approved the Master Plan for Developing Vietnam’s Automobile Industry*, Oct. 2004.

3. Finance and supporting policies

According to the master plan, the industry needs 16,000-18,000 billion VND (1-1.1 billion USD) in the period 2001-2010 and 35,000-40,000 billion VND (2.2-2.5 billion USD) in the period 2010-2020⁴. The government will provide credit to projects approved by the prime minister.

Seven supporting policies have been approved: (i) tariff policy; (ii) market policy; (iii) investment policy; (iv) science and technology policy; (v) human resource policy; (vi)

⁴ In the current Five Year Plan, total cumulative development investment in the period 2001-2005 is forecasted at 830,000-850,000 billion VND (59-61 billion USD) and thereafter expected to increase 11-12% per year. Of this total, 44% will be directed to the industrial sector (Nguyen 2004). This means that the planned investment for the automobile industry for the period 2001-2010 is nearly 2% of total development investment or 4.4% of development investment in the industrial sector.

capital attraction policy; and (vii) industrial management policy. The main contents of these supporting policies are the government’s commitment to assist the automobile industry in various ways. For instance, government will charge no tariff on CKD and IKD imports and allow one-year corporate income tax exemption after the introduction of a new model (called the “period for testing products”). The science and technology policy stipulates that official financial support will be available to R&D activities as well as projects which transfer modern technology of multinational corporations (MNCs) to produce (i) engines and gearboxes, and (ii) drive, transmission, and steering parts. There will also be a budget for training and re-training of managers, designers, and professional workers. The equitization of automobile assemblers and manufacturers is a priority.

4. Implementation

As with any other master plan, responsibilities are allocated among many organs. The following bodies and are specified in the implementation section of the master plan:

Table 4. Main Responsibilities of Implementing Organizations

Organization	Responsibility
Ministry of Industry	To promulgate standards of assembling and manufacturing enterprises
Ministry of Science and Technology	To calculate method of localization, standards for vehicles, technology transferring
Ministry of Finance	To solve tariff issues and promulgate financial support policies
Ministry of Transport	To promulgate new regulations on safety
Ministry of Trade	To prevent smuggling and promote exports
Ministry of Planning and Investment	To call for FDI projects and “to help” current firms follow investment licenses
Ministry of Police; People’s Committees; Ministry of Transport	To limit the number of registered vehicles
Vietnam Association of Mechanical Enterprises; Vietnam Automobile Manufacturers Association; Vietnam Society of Automotive Engineers	To strengthen cooperation and linkage within industry; To propose supporting policies to develop the industry in accordance with approved strategy and master plan
Enterprises authorized to manufacture specialized vehicles from chassis	To meet the requirements stipulated in the current master plan (deadline: July 1, 2005)

Source: Compiled from the *Decision 177/2004/QĐ-TTG approved the Master Plan for Developing Vietnam's Automobile Industry*, Oct. 2004.

5. Comparison with the Thai master plan

While the master plans of automobile industries in other countries should not be replicated uncritically in Vietnam, they offer a useful reference point against which Vietnam's master plan can be evaluated⁵. Let us briefly look at the master plan of Thailand.

The current Thai master plan⁶ provides both quantitative and qualitative objectives. It emphasizes two main goals, namely, total production and exportation. The quantitative targets are also spelled out for localization. Like Vietnam, the Thai master plan presents the orientation of the development of the Thai automotive industry. However, unlike Vietnam, it also specifies detailed action programs including concrete projects and key success indicators.

Two core strategies are presented in the Thai master plan. They are (i) the strategy to create predictable environment for business operation, and (ii) the strategy to enhance competitiveness of the Thai auto parts industry. In its action plan, projects supporting each strategy are specified (Table 5). Eight projects are proposed for the first strategy and seven are proposed for the second. It should be noted that all of these projects support businesses *indirectly* rather than directly specifying key players or required investment amounts as in the Vietnamese master plan.

Table 5. Thai Master Plan: Projects Supporting Two Core Strategies

Strategy	Supporting Projects
Creating predictable environment for business operation	<ol style="list-style-type: none"> 1. Industry situation analysis project 2. Automotive information center 3. Automotive training center 4. Automotive engineer development project 5. Competency certification system development project 6. Market responsiveness project 7. Automotive tax structure research project

⁵ In Malaysia, the term *automobile industry* is defined narrowly as passenger cars. It is a sub-sector of the motor vehicle sector which includes passenger cars, commercial vehicles, four-wheel drive vehicles (4WD) and motorcycles (Bumiputra Commerce Bank Bhd, 2003). In Thailand, the terms *automobile* and *automotive* refer to passenger cars and pick-up cars and trucks (Tiasiri, 2002). In Vietnam, the master plan of the automobile industry includes cars, coaches (buses) and trucks.

⁶ *The Master Plan for Thai Automotive Industry 2002-2006*, proposed to the Office of Industrial Economics, Ministry of Industry, by Thailand Automotive Institute, September 2002.

	8. Plan for the expansion of infrastructure necessary for industrial development
Enhancing the competitiveness of the Thai auto parts industry	<ol style="list-style-type: none"> 1. Cluster-based development project 2. Automotive standard project 3. Automotive products standard testing center 4. Automotive research and development center 5. Export promotion center for auto parts 6. Supplier development program 7. Product development project.

Source: *The Master Plan for Thai Automotive Industry 2002-2006*, Sep. 2002.

The expected form of output and the key success indicators are also specified concretely for each project. For instance, the industry situation analysis project is required to produce monthly and quarterly analyses on the automotive industry and its performance is assessed by the percentage of automotive assemblers and suppliers which have access to its analyses. Similarly, the automotive information center must build an easily accessible website on the industry and its success is judged by the number of research reports using the data provided by this center.

The Thai master plan also specifies responsible organizations and associations for its implementation. This is the same as the Vietnamese master plan.

6. Weaknesses

We raise five points below as the weaknesses of Vietnam's current master plan requiring urgent reconsideration.

(1) Unclear positioning of Vietnam in the regional production network

It is a must for Vietnam to study external trends in order to (i) effectively position its automobile industry in the regional context; and (ii) design appropriate supporting policies to achieve the positioning goal. Countries on the positioning map and value chain analysis should at least include China, Thailand, Malaysia, Japan, Korea, the United States, and Vietnam. This analysis is lacking in the current master plan.

Thailand has announced its positioning goal as becoming the "Detroit of Asia" or, more specifically, "the automotive production base in Asia that adds value to the country with a strong domestic supplier base." Currently, Japanese automobile

manufacturers regard Thailand and China as two alternative locations for large-scale manufacturing and assembly in East Asia. By carefully examining the behavior of automobile MNCs in China and Thailand, Vietnam should discover a “niche” on which priority and focus can be given. Final business decisions are up to investors but the Vietnamese government can send a strong signal to welcome them.

Malaysia attempts to position itself as the “designer of ASEAN cars.” In the industrial master plan of Malaysia, the automobile industry is a priority industry. In the mid 1980s, the Malaysian government launched a national car project which paved the way for the local automotive industry and supporting industries. Two Malaysian automobile manufacturers, Proton and Perodua, were established and protected in the hope of becoming important players in the global automobile market. At this moment, however, the Malaysian government admits that trade liberalization is a real threat to its automobile industry.

How should Vietnam position its automobile industry? Is Vietnam going to be the production base of certain special vehicles? Is Vietnam going to be the leading producer of gearboxes and engine parts as well as drive, transmission and steering parts? Is Vietnam going to be an R&D center of MNCs in the South East Asia? It is not yet clear.

(2) Unexplained assumptions for demand forecast

Since the development of the automobile industry critically hinges on market size, it is important to examine how market demand for 2005, 2010 and 2020 are forecasted and what assumptions were made in this process. If the forecasts are unreliable, the credibility of the entire master plan will be questioned.

Since taxes and tariffs will have a great impact on the growth of the domestic automobile market, demand forecast should be conditional on these policies. In preparation for the next round of revision of the master plan, alternative domestic demand scenarios corresponding to the different paths of tariffs and special consumption tax should be presented.

A related issue is the ambiguous position of the Vietnamese government regarding the desirability of domestic demand growth. It is evident that a healthy development of the automobile industry calls for a large and growing domestic

market, but Vietnam has only a very small market at present (Part II, section 4). Naturally, the industrial strategy should include demand expansion as an important pillar. At the same time, Vietnam has traffic problems caused by rapidly increasing motorbikes and automobiles. The master plan designates the Ministry of Police, the Ministry of Transport, and various levels of the People's Committees to limit the number of registered vehicles (Table 4). Does Vietnam intend to develop its automobile market or suppress it? Are the projected numbers of vehicles for 2005, 2010 and 2020 (Table 1) consistent with this policy objective? This also remains unclear.

(3) The leading role of the automobile industry?

Vietnam chooses the automobile industry to be an *important industry* (see footnote 2) but there are some negative factors that may impede its success.

First, as noted above, Vietnam is imposing policies to limit the number of cars sold in the market. If the market demand for automobile is low, the production scale is small. If the production scale is small, the spillover effect is limited.

Second, supporting industries for the automobile industry are undeveloped in Vietnam. Currently, there are about 2,000 automobile part suppliers in Thailand (Tiasiri, 2002) while the corresponding number in Vietnam is only 60 (Quach, 2004).

Ohno (2004b) suggests that the supporting industries of the automobile industry can overlap with those of the motorbike industry and electronics. Both Vietnamese and FDI motorbike producers have already begun to link with domestic suppliers with some success. The growth of automobile and electronics industries can promote a further agglomeration of domestic suppliers since the three industries can be served by overlapping suppliers in such areas as processing of plastic and metal⁷. But such strategic thinking is missing in the current master plan.

(4) Supporting policies are comprehensive but not concrete.

⁷ Among 709 first-tier suppliers in the Thai automotive industry, there are 386 that supply to car assemblers, 201 that supply to motorbike assemblers, and 122 that supply to both car assemblers and motorbike assemblers (Tiasiri, 2002).

Unlike the Thai master plan, Vietnam's master plan cannot be implemented as such since concrete action plans and projects are yet to be identified. Even though seven supporting policies are mentioned, the industrial strategy still remains general. As with other Vietnamese laws and decisions, this master plan must wait for detailed documents by relevant ministries before it can be put into practice. The crucial question therefore is: what should be the contents of the concrete actions and projects to come?

While the manufacturing of engines and gearboxes is targeted, supporting policies for this purpose are lacking. In investment policy, three solutions given are only directions. Foreign invested enterprises are required to follow the Law of FDI in Vietnam, which can hardly be called a strategy. The government is determined to support R&D but who will conduct it and what type of R&D should be encouraged remain unspecified.

(5) Poor coordination among involved parties

This is also the situation with not only the automobile industry but also all other industries. For an effective implementation of an industrial strategy, three types of cooperation are needed: (i) production linkage between local enterprises and MNCs operating in Vietnam with the former supplying parts and services to the latter, (ii) coordination among ministries and other official bodies in implementing the master plan in a consistent manner, and (iii) close and regular channels between the business community and policy makers to implement and revise the policy in a realistic way. Since all of these are underdeveloped in Vietnam, the master plan must propose steps to build these cooperative relations.

Even though many things have been concretized relative to the previous "strategy," for all these reasons the current master plan has not sent a strong positive message to the automobile manufacturers in Vietnam, especially foreign invested ones.

Part II. Remaining Issues

In the remainder of this paper, we will raise five more issues that must be taken into account when implementing or revising the current master plan. Some topics may overlap with the arguments in Part I, but they are reiterated since we consider them to be highly important.

1. The East Asian production network and Vietnam's positioning strategy

East Asia should be regarded as one big factory in which each country plays a specific role and contributes to the overall production scheme. In this region, enhancing industrial capacity independently from neighboring countries is impractical and ineffective. China and ASEAN4 are Vietnam's competitors as well as potential partners in production. Vietnam should not compete directly with these countries in the fields in which they excel. Instead, Vietnam should identify its dynamic comparative advantage, build industrial agglomeration around it, and participate in the regional production network to supplement and enhance the capability of other countries. As Vietnam grows, the production capacity of East Asia as the factory of the world should be strengthened.

Another factor that accelerates regional cooperation in manufacturing is pressure toward free trade. AFTA and other free trade initiatives are prompting MNCs to reconsider business strategies in general and the reallocation of production capacity in particular. This includes (i) establishing one mother factory in the region; (ii) building a network of sub-factories which supports the mother factory; and (iii) concentrating production on each country's core competence only and outsourcing other products and services.

Each industry must be studied carefully since situations are different from one industry to another. In automobile, Thailand has emerged as the regional production center boasting a large agglomeration of supporting industries, a trend that is accelerating under regional free trade. Vietnam, a country which started modern automobile production three decades behind Thailand, should not try to replace Thailand as the mother factory. Instead, Vietnam should support and complement the Thai automobile industry and thereby enhance the regional production capacity and product mix. More concretely, the following two strategic pillars are recommended for Vietnam (the early signs of these movements are already observed).

- *Parts exportation:* Vietnam should become an export base for selected automobile parts. Production should be large-scale and initially 100% export-oriented since domestic parts demand is currently too small. But over time, parts can also be

supplied to domestic assemblers as the domestic market expands.

- *Assembly of certain car models:* Vietnam should assemble certain automobile models which are not produced by the mother factory in Thailand or elsewhere, especially those that require small lots and frequent modification in specs (since Vietnam's automobile industry has developed under such conditions). It is up to MNCs to assign particular models to be produced in Vietnam, but the Vietnamese government can actively encourage and work with MNCs to promote such a move.

2. Creating a new business-government relationship

In the years of economic planning, the government had direct control over producers. Collecting information and implementing policies were relatively easy since SOEs obeyed official instructions. However, as private and foreign enterprises become increasingly important and even SOEs are asked to equitize and operate under market pressure, the old method of telling SOEs what to do no longer works. New policy formulation is urgently required. For this purpose, building new and constructive channels between business and government is essential.

Policy must now respond effectively to changing global and regional environment as well as the requirements of domestic and foreign producers to become competitive. Output, investment and localization cannot be simply dictated. Policy must be designed, implemented and adjusted through close and frequent interaction between MOI and producers. Although the reality has changed drastically, no such channels have been created in Vietnam. This is the reason why many policy measures remain unrealistic and cause serious problems with producers and investors. The business companies, both domestic and foreign, often write letters to the prime minister or relevant ministers when a serious problem arises. The popularity of such an appeal to the top level is a sad proof that there is no working mechanism within the economic ministries to prevent or solve such troubles.

The automobile industry is no exception. It is absolutely necessary to install an effective feedback mechanism between producers and policy makers in order to continuously implement and revise the automobile master plan in a realistic manner. The existing channels (Business Forum, government-investor dialogue, bilateral negotiations, symposiums in big hotels, and so on) are useful but a bit too formal and too infrequent. It is very difficult for anyone to debate relevant issues thoroughly in such a setting. The government must develop more regular and informal channels to share information and views with the business community. The past experiences of other East Asian countries may

prove quite useful after necessary modifications are made to fit Vietnam's specific situation⁸. Trust and cooperation must be fostered between the two parties while avoiding the risk of collusion.

The Vietnamese government often accuses foreign automobile manufacturers for high car prices and low localization despite a long period of protection and preferential treatment. Foreign producers counter that such favorable treatment was more than offset by the suppression of market growth through increasing taxes greatly in an environment where as many as eleven manufacturers compete in the tiny domestic market. Each side may have a point, but this kind of acrimonious exchange over the past failure of each other is highly counterproductive. Both sides should reach out to build a more constructive and forward-looking relationship based on mutually agreed domestic demand forecast (there may be more than one scenario depending on tax rates) and Vietnam's strategic positioning in the regional automobile production. The government side should revise the master plan to make it more realistic while the producer side should propose a business plan which can be achieved under a favorable policy environment.

Automobile companies often hesitate to reveal their future business plans to their competitors. If so, they can use research institutions or business associations to communicate their business directions more generally and anonymously.

3. Comparison of automobile and motorbike industries

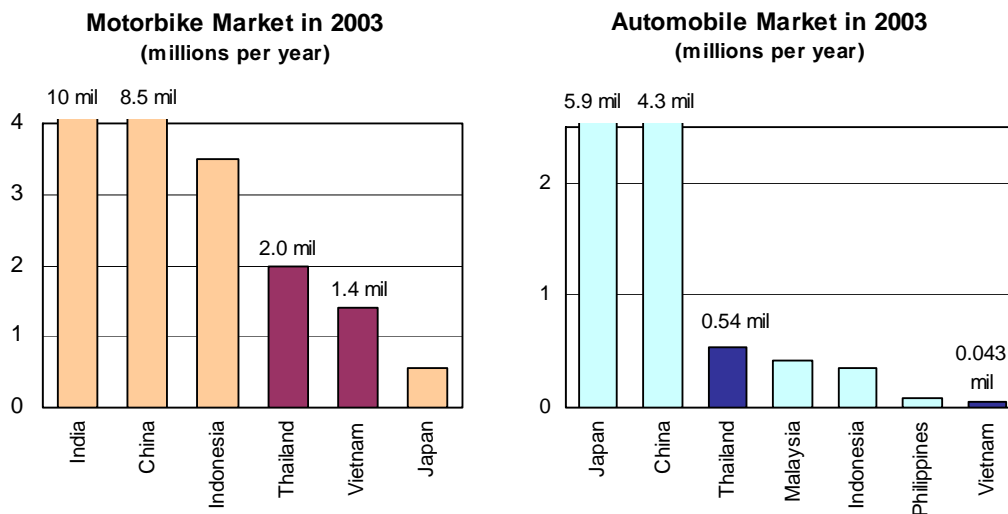
The motorbike industry is growing more strongly than the automobile industry in Vietnam despite many recent problems such as the China shock, component import quotas, and registration restriction. The cost reduction and localization of motorbikes are much more advanced than automobiles. It is important to understand why motorbikes *far* better than automobiles in Vietnam. The main differences are as follows:

- *Market size*: the domestic market of motorbikes (1.4 million units per year in 2003) is sufficiently large and close to the size consistent with production efficiency. If there were no production or registration restrictions on motorbikes, it would by now be as big as the Thai market (2 million). Meanwhile, the automobile market in Vietnam is miniscule (0.043 million in 2003) and there is no condition for achieving scale merit at the moment (Figure 1).

⁸ For example, in the 1960s the Ministry of International Industry and Trade (MITI) of Japan had a very close relationship with the business community through deliberation councils, study groups, joint R&D, personnel rotation, cooperation in export and investment adjustment, official loan programs, and other daily contacts.

- *Product complexity*: relatively speaking, automobiles require more parts, higher design integration, and greater safety and comfort standards than motorbikes due to larger size, more functions, and higher speed. The automobile industry must therefore be supported by a broader and more complex industrial base than the motorbike industry. Such an industrial base is hardly available in Vietnam.
- *Modeling to market*: automobile design is often similar across countries (Toyota Camry is popular around the world, for example) but motorbike design must adjust to local demands. Vietnamese motorbike riders go slower but carry more people or load than Thai riders. Thus, automobiles tend to be produced in one central location in large scale but motorbikes must be assembled locally to satisfy domestic customers. For this reason, it is more difficult for a latecomer country to start automobile production than to start motorbike production.

Figure 1. Comparing Market Size in Asian Countries

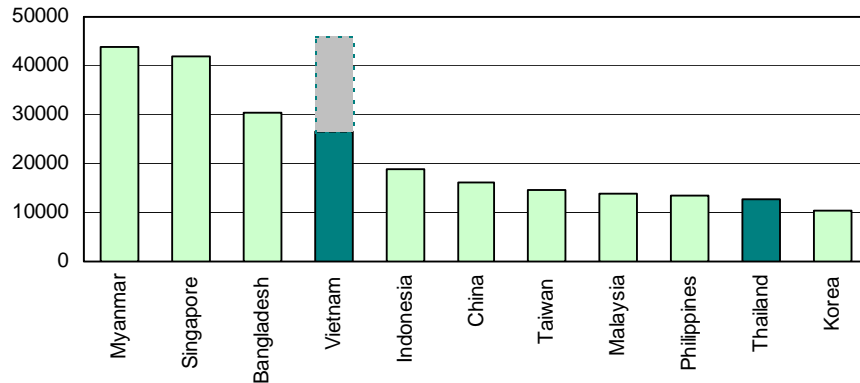


Source: JETRO Hanoi.

4. Two causes of the high price

Car prices in Vietnam are high. According to the JETRO survey, the price of 1500cc sedan in the capital city as of late 2003 is as follows: Vietnam (\$26,500), Indonesia (\$18,801), China (\$16,310), Taiwan (\$14,802), Malaysia (\$13,965), Philippines (\$13,511), Thailand (\$12,663), and Korea (\$10,365). Meanwhile, Myanmar (\$44,000, second-hand model), Singapore (\$41,841) and Bangladesh (\$30,524) report higher prices than Vietnam.

Figure 2. Automobile Price Comparison (USD, November 2003)



Source: JETRO, *The 14th Survey of Investment-Related Cost Comparison in Major Cities and Regions in Asia* (March 2004).

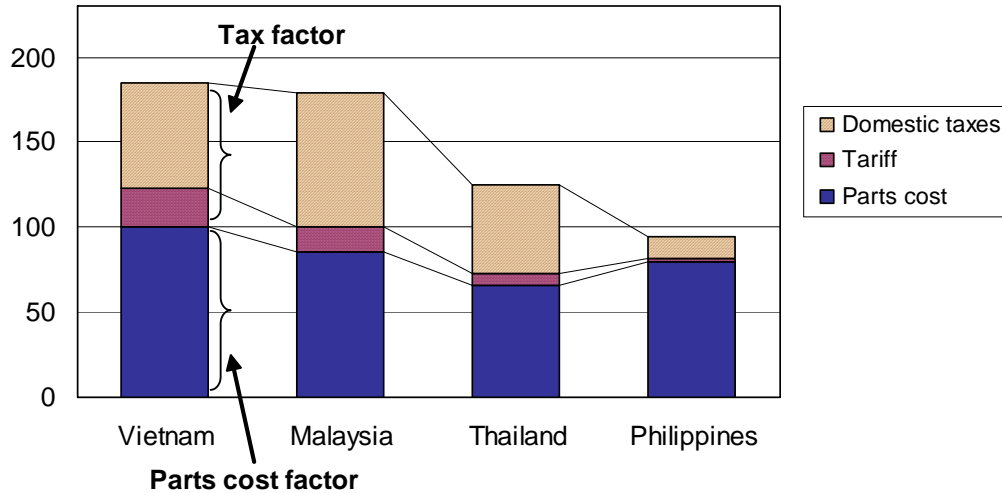
Note: The dotted grey area corresponds to JAMA simulation under the full implementation of SCT increase by 2007—see Table 6 below.

Figure 3 below presents the cost decomposition of a domestically produced automobile across countries⁹. The cost can be decomposed into two main parts: (1) *parts cost factor* and (2) *tax factor* (tariffs and domestic taxes)¹⁰. Among the four countries, Vietnam has the highest cost followed by Malaysia which has had a (not very successful) national car program. On the other hand, the Philippines enjoys a very low cost (about the half of Vietnam) thanks to low tariff and taxes. It is also clear that the higher is automobile agglomeration, the lower is the parts cost in that country. Vietnam's cost is 48% higher than that of Thailand, the largest automobile producer in ASEAN. This gap is decomposed into the parts cost gap (56%) and the tax gap (44%).

⁹ VDF estimate for a typical Japanese model. Figures 2 and 3 are not directly comparable since methodology and car models are different.

¹⁰ Due to data limitation, other costs are not included in these estimates.

Figure 3. Automobile Cost Comparison in 2004
(Vietnam's parts cost = 100)



Source: VDF estimate for a typical Japanese car model.

From this, we can identify two causes of the high automobile prices in Vietnam. First, the small market prevents producers from achieving cost reduction. Market size is a critical factor in the development of the automobile industry. A large market implies scale merit, high efficiency, strong growth of supporting industries and the possibility of a broader product mix, while a small market means the opposite of all these. The Vietnamese automobile market, while growing strongly in the past few years, is still too small to realize production efficiency (Figure 1 above). In international comparison, Vietnam has far fewer cars than countries at similar income levels.

The other reason for the high price is the relatively high tariffs and domestic taxes in Vietnam. Moreover, the government intends to raise these taxes drastically on automobiles produced in Vietnam. The effective rate of the special consumption tax (SCT) for domestically produced cars is being raised in steps from 5% in 2003 to as high as 80% in 2007 and beyond. This is intended to attain equal treatment between domestic and imported products. While this objective is laudable from the viewpoint of trade liberalization and WTO negotiation, it inevitably causes a sharp increase in car prices in Vietnam which are already too high, offsetting any cost reduction effort of producers. If we combine the JETRO survey (Figure 2) and the JAMA estimate (Table 6), it is predicted that, by 2007, Vietnam would have the highest automobile price in East Asia surpassing that of Myanmar and Singapore (the dotted area in Figure 2) mainly because of high taxes. This will surely

have a negative impact on the growth of the domestic car market.

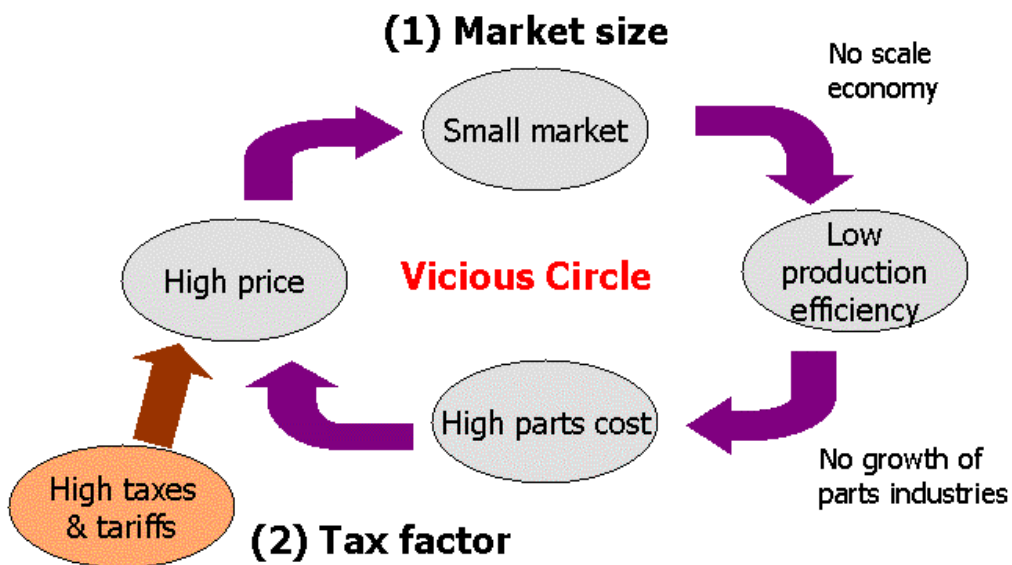
Table 6. Scheduled Increase in Special Consumption Tax

	2003	2004	2005	2006	2007
Special Consumption Tax for domestically produced cars	5%	24%	40%	56%	80%
Retail car price, JAMA simulation (2003=100)	100	122	137	152	174

Source: Japan Automobile Manufacturers Association, "Impact analysis of Vietnam market by 2004 taxation system change," slides, August 2004.

Prices, market size, and taxes are thus mutually related. In the case of Vietnam, the combination of a very small market and high taxes results in low efficiency and high cost, which in turn perpetuates a small market. This vicious circle must somehow be broken.

Figure 4. Two Causes of High Prices



5. Coping with traffic problems

Fast income growth is generating a boom in the automobile and motorbike markets, causing traffic congestion, accidents and air pollution especially in and around Hanoi and HCMC. The pace of urban planning, traffic policy renovation and infrastructure construction does not seem able to keep up with the rapid increase in traffic volume. The non-observance of traffic rules further aggravates the situation. Coping with these problems has become a

national priority, and responsible authorities are urged to take effective measures.

However, ad hoc and temporary measures are often counter-productive. A proper mix of short-, medium- and long-term policies are needed to solve these problems. The government is required to improve its capacity to design and implement an integrated policy package. In the short run, strict enforcement of traffic laws, better traffic-flow management, and mobilization of traffic police are called for. In the medium run, the provision of more bus lines, widening of major streets, and improved intersections and ramps are necessary. In the long run, transportation infrastructure such as bridges, tunnels, new highways, bypasses and subways must be constructed. A good traffic master plan should guide these phased policy actions.

At present, some local authorities have suspended motorbike registration in certain urban districts in an effort to curb the traffic volume. In a similar vein, the rising tax on automobiles is sometimes justified as a measure to slow down the number of cars on the street. However, these suppressing measures are often ineffective since popular demand for cars and motorbikes is very strong and there are a number of ways to circumvent such measures. They must be replaced by a proper policy mix as explained above as soon as possible.

At the same time, the producers of motorbikes and automobiles should bear a part of responsibility to restore traffic order and reduce accidents and air pollution. They should work actively with the Vietnamese government to fulfill *corporate social responsibility* under clear guideline and cooperative spirit. While this will add to their current cost, the healthy growth of the transportation sector will greatly improve the business environment and popular support for these industries in the long run.

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