



# Avoiding the Middle Income Trap:

## Renovating Industrial Policy Formulation in Vietnam

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**October 2008**

### Topics

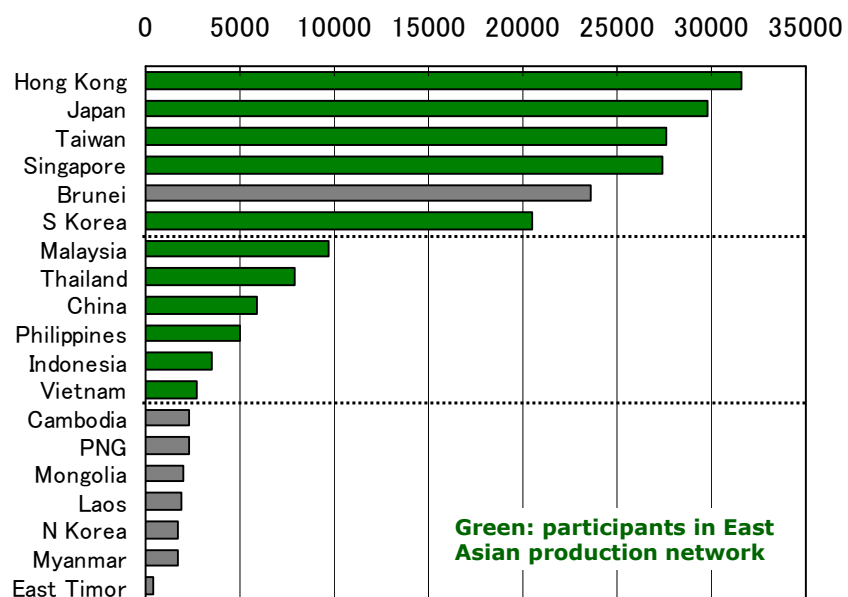
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- Vietnam's challenge:  
creating internal value and avoiding the  
middle income trap
- Policy structure
- Policy making procedure and  
organization
- How to break a solidified system:  
leadership, technocrat group, and  
strategic foreign partnership

## Vietnam's New Era

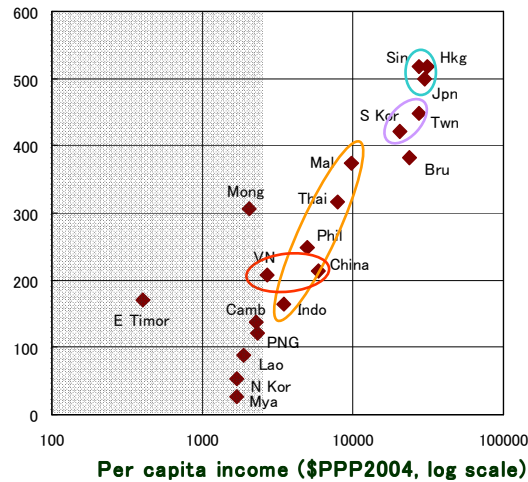
- Vietnam is entering a new era where productivity breakthrough and value creation are needed.
- Opening up and receiving FDI can attain middle income (\$1,000+), but higher income (\$10,000+) requires *good policy* and *private dynamism*.
- Vietnam's future depends on:
  - Creation of internal source of growth
  - Coping with new social problems
  - New macroeconomic management

### Per Capita GDP in 2004 (\$ PPP) World Bank data



## Diversity in Governance and Economic Development

Governance, WGI2005



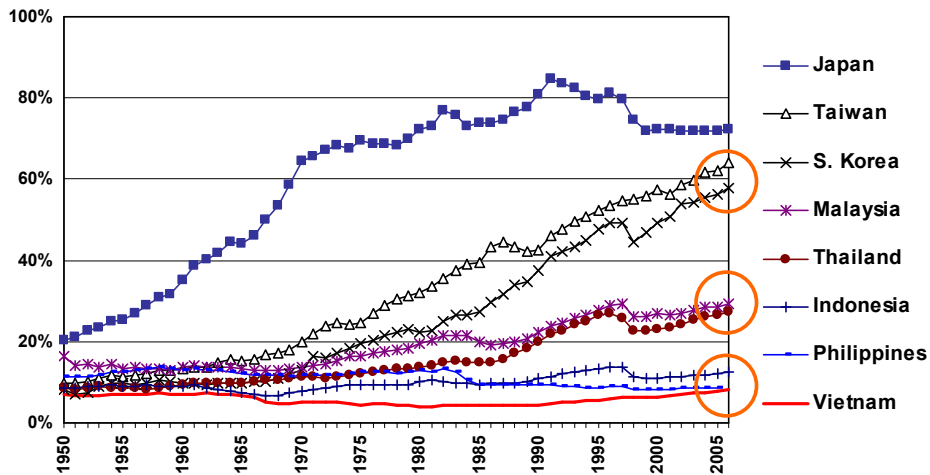
High correlation (0.90) but causality cannot be argued from this diagram

Only circled economies participate in regional dynamism

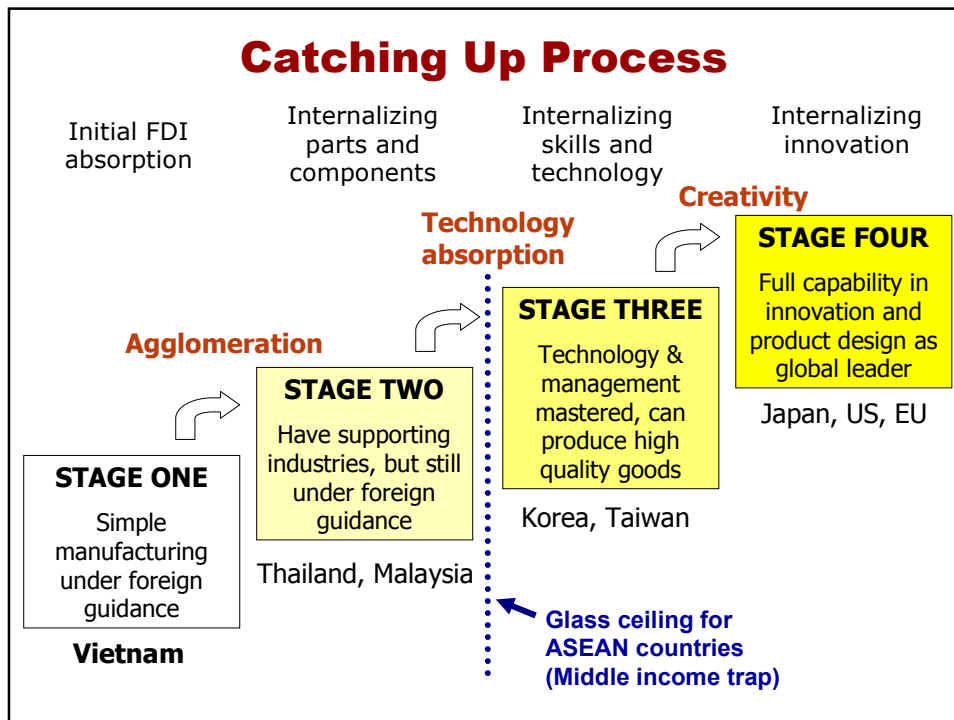
Sources: Compiled from World Bank, Worldwide Governance Indicators, Sep. 2006; and World Bank, World Development Indicators, 2006.

## Different Speeds of Catching Up

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



Sources: Angus Maddison, *The World Economy: A Millennium Perspective*, OECD Development Centre, 2001; the Central Bank of the Republic of China; and IMF *International Financial Statistics* (for updating 1998-2006).



## Lessons from Thailand and Malaysia

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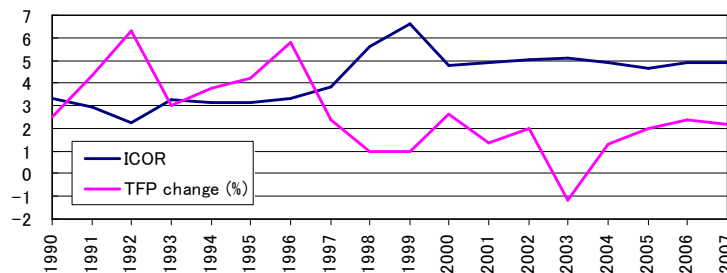
**(Success)** Impressive industrialization and growth led by FDI and reasonable policy

**(Failure)** Domestic private-sector capability is still weak after many decades

- Foreign dependency—inability to send foreign managers home
- Value and capability are not internalized—middle income trap
- Risk of wage pressure and FDI shift to China/India/Vietnam

## Vietnam's Changing Sources of Growth

- Doimoi to mid 1990s—liberalization effect
- Mid 1990s to now—externally driven growth with large inflows of investment, capital and aid
- From now—creation of internal value!

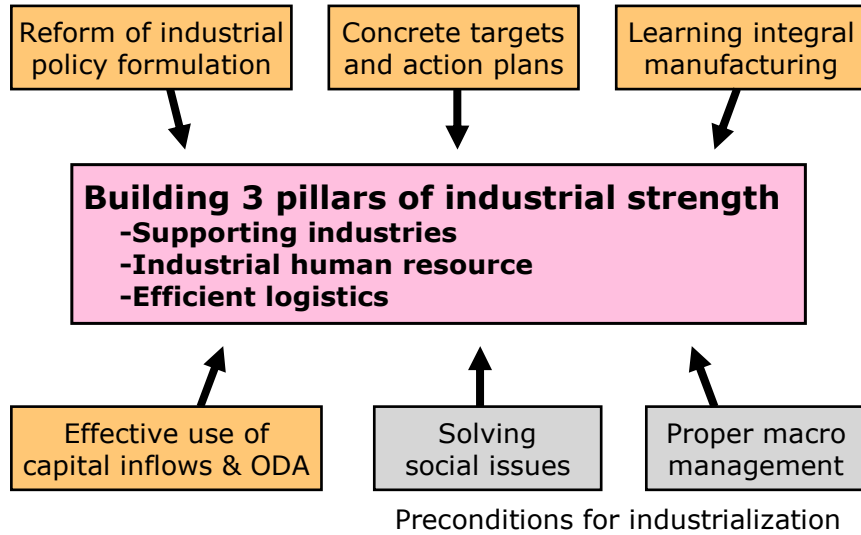


## Vietnam's Challenge

- AFTA, WTO, FTAs - large inflows of ASEAN products (esp. Japanese brands) may destroy VN's industrial base.
- The risk of losing manufacturing base and keeping only sales agents ("hollowing-out").
- Vietnam's wage becoming too high for labor-intensive industries, but technology too low for knowledge-intensive industries.
- Vietnam needs a strategic partner to greatly increase internal value in manufacturing.

## Proposed Strategy for 2020

(Presented at VDF Conference, Hanoi, March 2008)

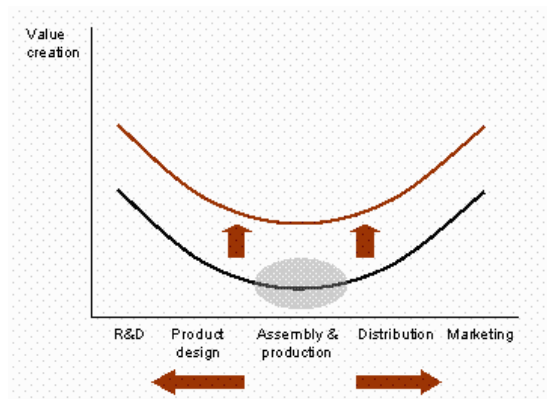


## Malaysia's Manufacturing++

Malaysia's IMP2 (1996-2005) aimed at raising and broadening the value chain.

### Leveling up of each industrial cluster

- Core production
- Supporting industries
- Supporting services
- Human resources
- Logistics
- R&D



## The Concept of Monozukuri

### Japanese Style Skill-based Manufacturing

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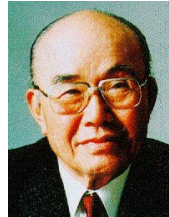
- *Monozukuri* literally means “making things” in native Japanese.
- Pursuit of high quality and customer satisfaction as the primary goal, with pride and dedication.
- Many of Japan’s excellent companies were founded by engineers full of monozukuri spirit.



Sakichi Toyota  
1867-1930



Konosuke Matsushita  
1894-1989



Soichiro Honda  
1906-1991



Akio Morita  
(Sony’s co-founder)  
1921-1999

## Monozukuri – cont.

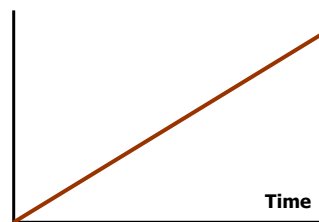
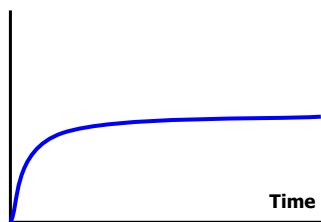
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- Long-term relationship and skill & knowledge building within companies and among companies (assemblers-suppliers).
- Strong demand for 5S, QCD (quality-cost-delivery), *kaizen*, just-in-time, quality control, and other efforts for constant improvement.

## Two Types of Business Architecture

	<b>Modular manufacturing</b>	<b>Integral manufacturing</b>
Parts interface	Parts are common and can be used for any model	Each product has unique parts, specifically designed
Merits	Quick results and flexibility	Endless pursuit of quality
Demerits	No differentiation, excess entry, low profit, lack of R&D	It takes much energy and time to achieve results
Institutional requirements	Openness, quick decision making, flexible outsourcing	Long-term relations, building internal skill & knowledge

Performance



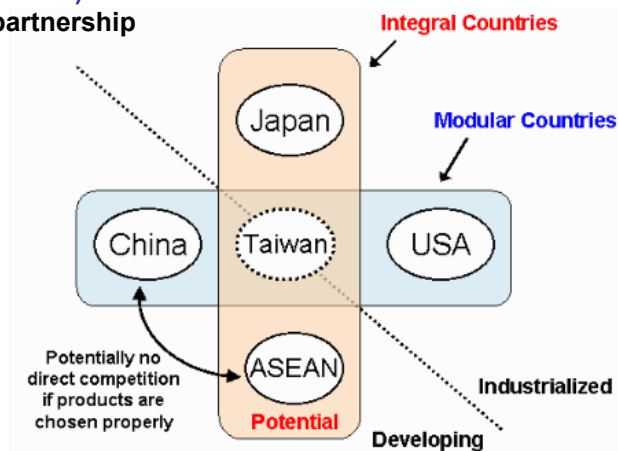
## Partnership Possibilities

### From the Viewpoint of Business Architecture

**Japan=ASEAN (integral)** and  
**USA=China (modular)** can  
form effective partnership



Source: compiled from Prof. Takahiro Fujimoto's explanation to the Joint VDF-MOI mission, June 2005.





## Policy Structure

East Asian industrial policy making has been characterized by:

- Real-sector pragmatism
- Goal orientation:  
Vision → Strategies → Action plans
- Enhancing unique strength rather than removing general negatives

Vietnam has a vision (*Industrialization & Modernization 2020*) but it is not backed by concrete strategies and action plans. The roadmap is unclear.

### <Malaysia>

Vision 2020 → IMP → OPP/Malaysia Plan → Budget  
“Become fully (15 yrs) (5-10 yrs) (annual)  
developed” 1991

### <Thailand under Thaksin> (2001-06)

PM’s vision → Auto Master Plan → Action Plan Matrix  
Become Business-MOI-experts agree on  
“Detroit of Asia” targets for car/motorcycle production & export

### <Ethiopia>

ADLI → Ind.Dev.Strategy → M/Ps → Exp.St.Committee  
1991 2003:policy principles Leather/garment/flower/  
food processing

### <Vietnam>

Goal 2020 → Overall industrial M/P? → Action Plan?  
10YS/5YP (Does not exist) (Does not exist)

## Serious Reform in Policy Method & Organization Needed

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- For continued industrialization, Vietnam needs a **fundamental reform in policy formulation**. Minor repairs of current system are not enough.
- **Government trap** – low efficiency, low morale, low salary → brain drain from the public sector → low-quality policies
- Strong political will and risk-taking at the top level (Prime Minister) is needed to initiate such reform.

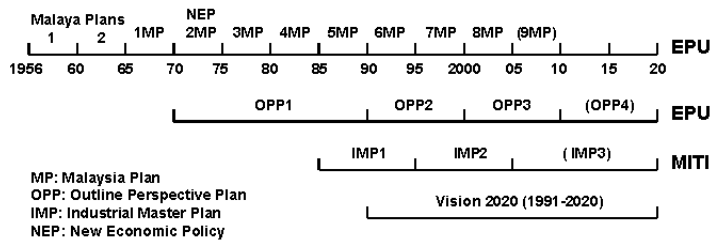
## “VN’s Policy Process Is One and Only”

K Ohno, VietnamNet Interview (May 13&15, 2008)

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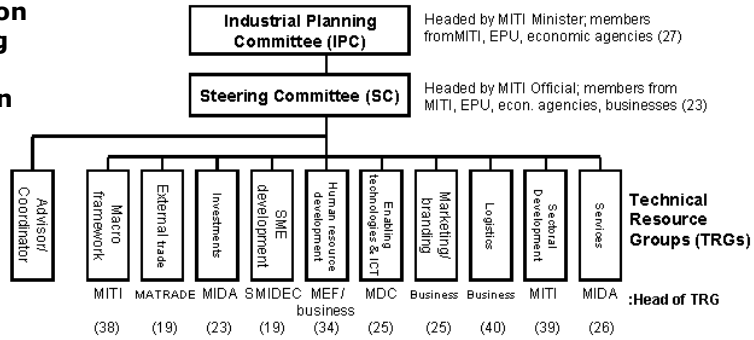
- VN’s growth thanks to good location and good workers; not because of good policy.
- Main problems are **lack of business involvement** and **lack of inter-ministerial coordination**. Policies are not supported by private sector and not implemented. These are unique weaknesses in VN not seen in other countries.
- The same people from planning years are still in charge. I propose a technocrat group directly under PM, as seen in many East Asian countries.

# Multi-layered Model



## Malaysia

### Organization for drafting Industrial Master Plan



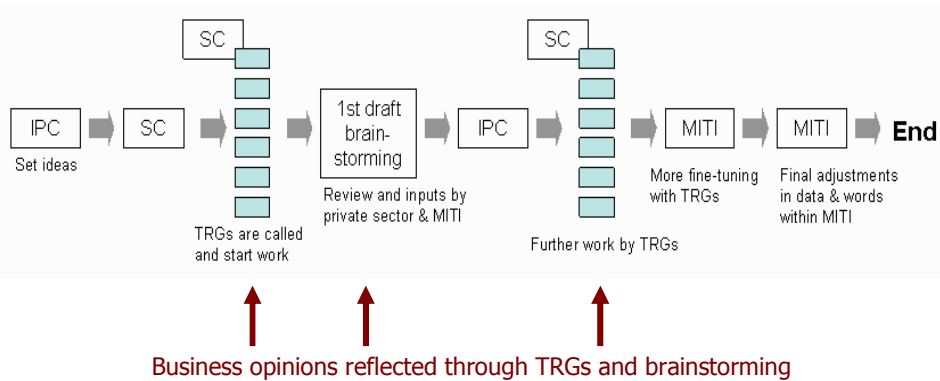
**Total 338 members + advisors**

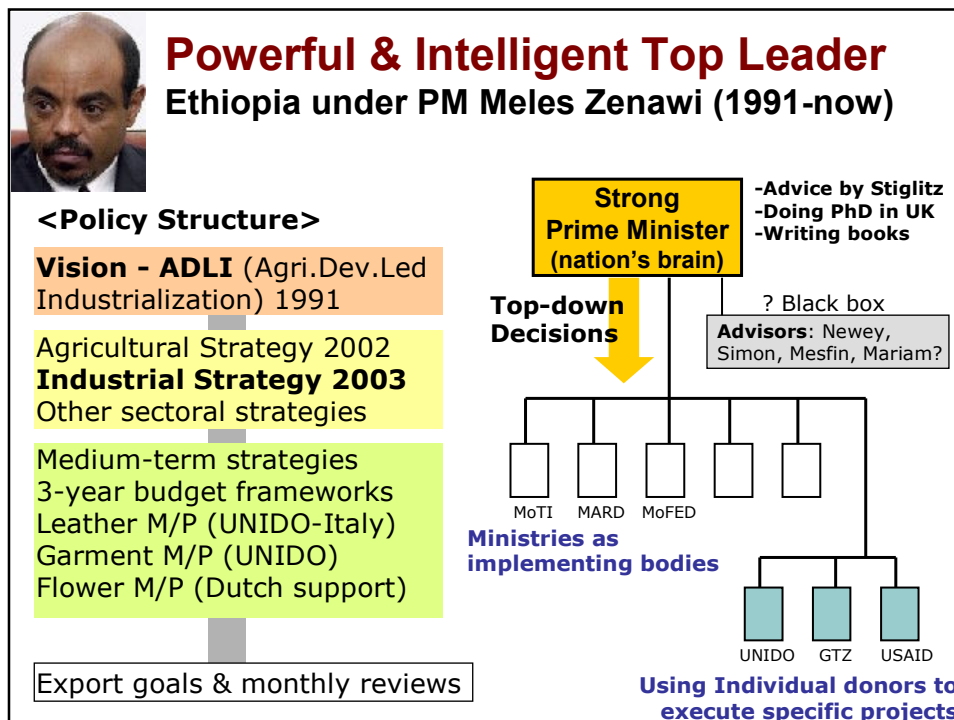
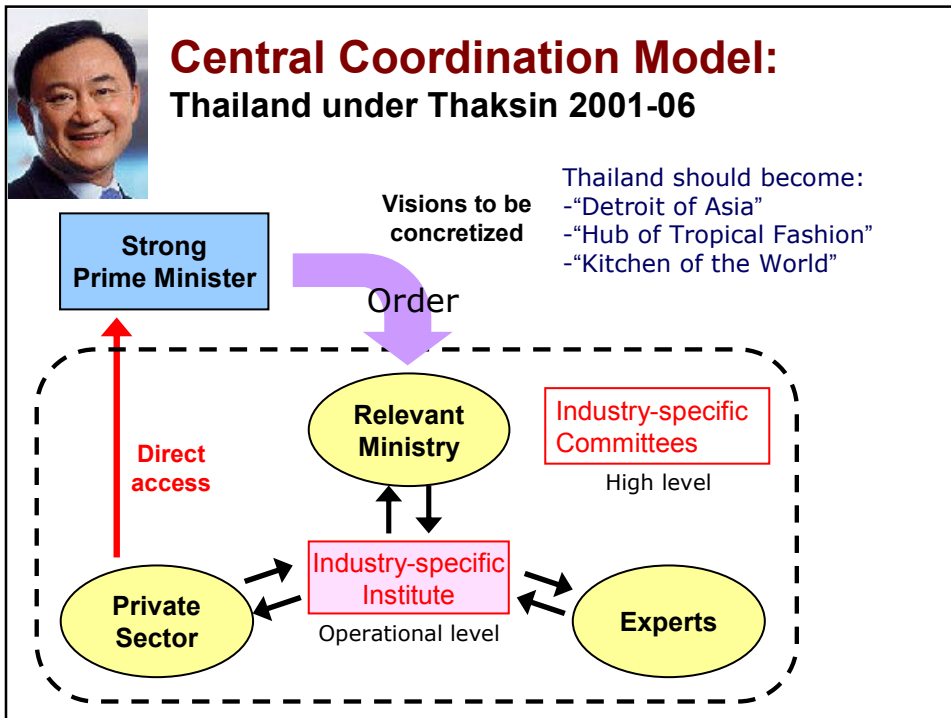
Source: MITI website.  
 Note: Numbers in parentheses indicate the number of members in each committee or group.

## Malaysia:

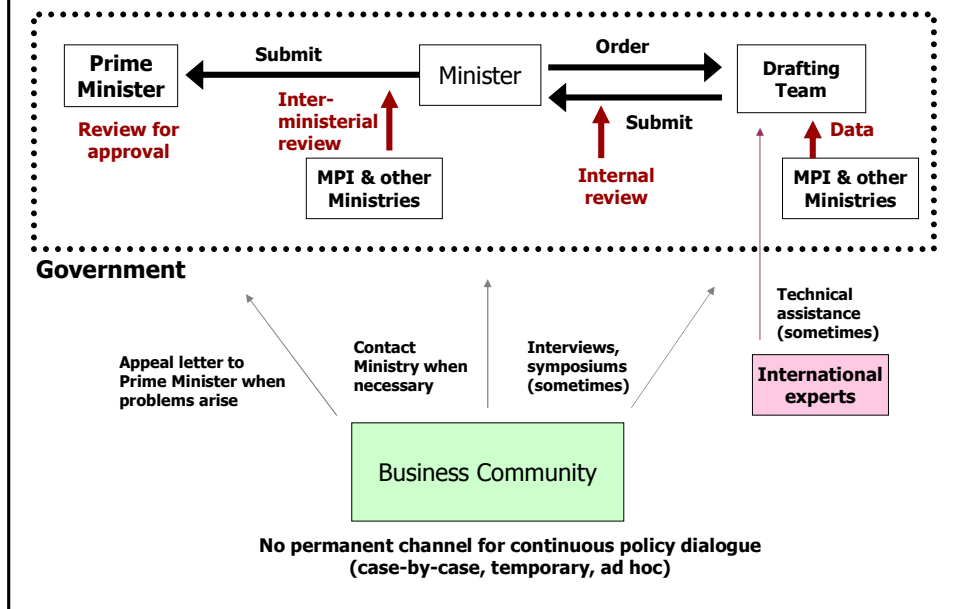
### Drafting of Industrial Master Plan 2006-2020 (IMP3)

IPC: Industrial Planning Committee (headed by MITI Minister)  
 SC: Steering Committee (headed by MITI high official)  
 TRGs: Technical Resource Groups (headed by various experts)



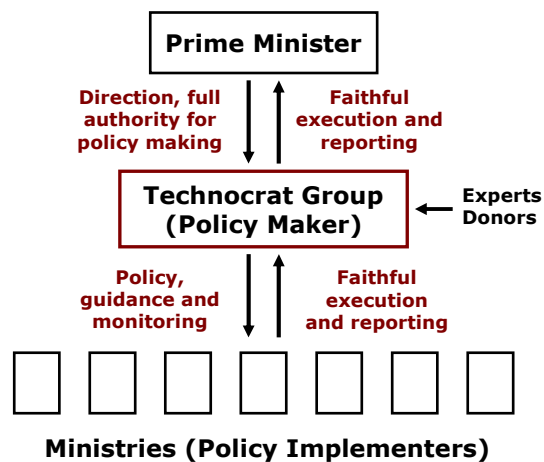


## Vietnam: Traditional M/P Drafting Process



## Policy Formulation for Vietnam: A Proposal

- Elite technocrat group under strong leadership of Prime Minister
- Choose young, well educated officials and experts
- Simplify policy authority and procedure





## Under New Policy Structure Vietnam Should Achieve:

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- Strong top-down visions from PM; sufficient authority for technocrats to execute orders
- Action-oriented policy making with speed and flexibility
- Removal of bureaucratic formalism & inaction, nepotism, corruption, secrecy
- Public sector renovation – compact size, competitive recruitment, attractive salary, performance-based promotion, pride to serve the country



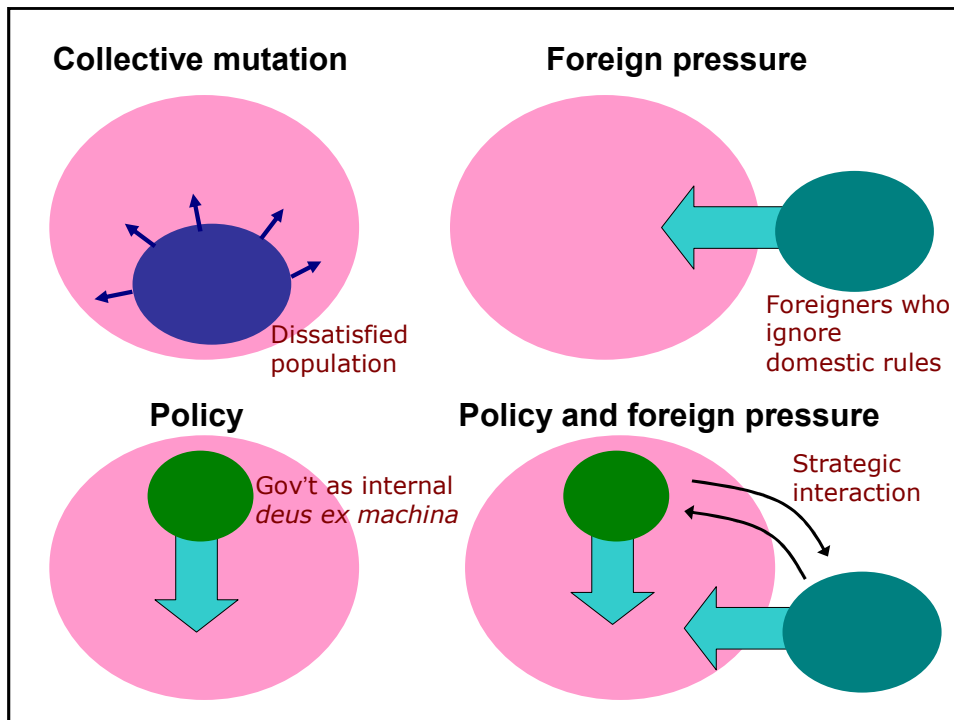
## Breaking a Solidified System

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According to comparative institutional analysis (CIA), a once-established system resists change because of:

- Institutional complementarity
- Strategic complementarity
- Path dependence

But CIA also tells us that a systemic change may occur under certain circumstances.



## Vietnam Can Change: Suggested Entry Points

**The following three should be enhanced and strategically combined:**

- Leadership
- Technocrat team
- Foreign partnership

The leader's vision should be concretized by the technocrat team. Foreign businesses, donors and experts should be mobilized to achieve this vision.

## **Vietnam-Japan Monozukuri Partnership for Supporting Industries**

**For Leveling Up Vietnam's Competitiveness in the Age of  
Deepening Integration**

### **A VDF Proposal**

- Drafted in June 2008 at the request of Japanese Ambassador as guiding ideas for new bilateral cooperation between VN and Japan. Revised in Aug. 2008.
- The content reflects VDF's studies on specific industrial sectors, supporting industries, and policy formulation methodology.
- It also summarizes various opinions of Japanese experts working in Vietnam.

## **Vietnam-Japan Cooperation in the Past**

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- Japan has contributed to Vietnam through trade, FDI, ODA and policy dialogue
- Contribution of Japanese ODA
  - Infrastructure (esp. transport & power), industrial skills and HRD, institutional reforms, business environment, urban & regional planning, removing negative impacts of growth, poverty reduction
- Action-oriented bilateral policy dialogue
  - Ishikawa Project (1995-2001)
  - New Miyazawa Plan (1999)
  - VN-Japan Joint Initiative Phase 1, 2, 3 (2003-09)





## New Direction of Vietnam-Japan Cooperation

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- Vietnam is no longer a low-income transition country. Bilateral cooperation should be more equal and strategic.
- Cooperation should shift from removing negatives and providing basics to proactive creation of new competitiveness.
- Jointly produce high skill products through division of labor:
  - { **Japan** – capital- & knowledge-intensive monozukuri processes
  - { **Vietnam** – labor-intensive monozukuri processes



## Japan's Challenge

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- Japan has high technology, but faces high wages and ageing population.
- **The 2007 Problem** - Postwar baby boomers (born 1947-49) with high skills began to retire in 2007. Young workers are in shortage. Situation will only get worse as time goes by.
- Japan needs a young developing country as a reliable partner in integral manufacturing
  - ➔ Prof. Fujimoto: Thailand & Vietnam are prime candidates



## Proposed Features of Monozukuri Partnership

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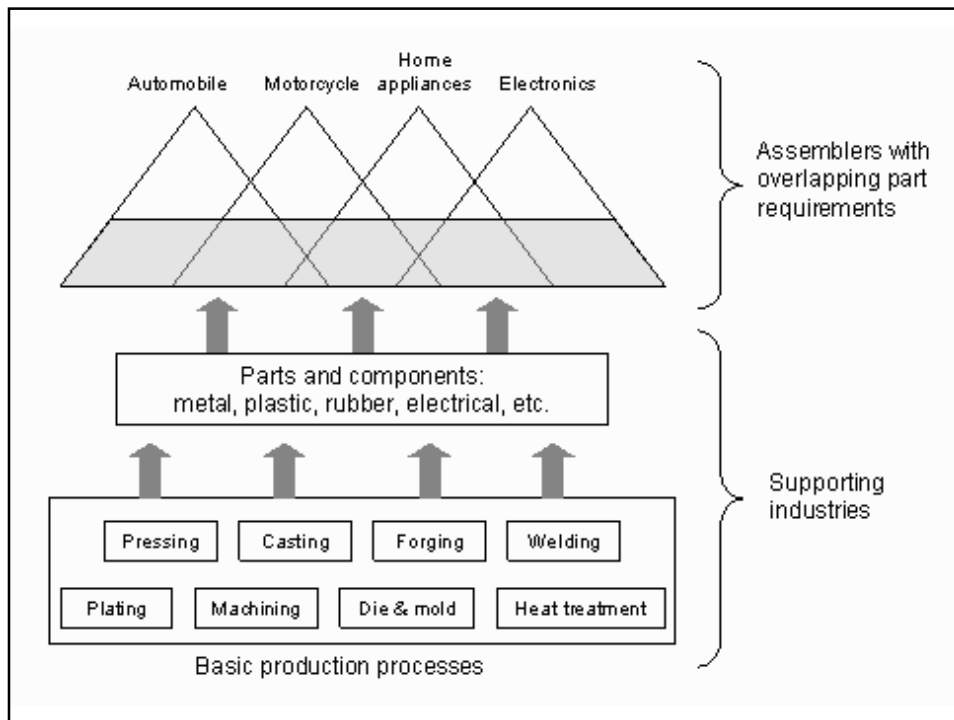
- **Resetting the mindset** – Vietnamese managers and workers must be more aggressive in learning and marketing
- **Technology transfer and capacity building**
- **Commitment to international standards** – quality, safety, environment, intellectual property
- **Positioning in the global value chain** – jointly specializing high skilled processes and outsourcing other inputs
- **Reforming policy methodology**
- **Non-exclusivity** (win-win-win) – other countries can also enjoy the benefits of this partnership



## Importance of Supporting Industries

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- Supporting industry promotion is the first important step to realize the vision of monozukuri partnership.
- Assembly-type manufactured products – large part cost (80-90%) vs. small assembly labor cost (5-10%).
- Without quick access to domestic suppliers with QCD, assemblers cannot compete (added transport cost + long lead time).
- ASEAN4 have been promoting supporting industries for a long time, but with limited success in creating non-FDI suppliers.



## Suggested Policy Menu

- Policy menu (next slides) is based on:
  - MITI's New Aid Plan for ASEAN, 1980s
  - Mizutani Report for Thailand, 1999
  - Urata Report for Indonesia, 2000
  - Vietnam's Supporting Industry M/P, 2007
  - Vietnam's Motorbike M/P, 2007
  - Opinions of Japanese and Vietnamese experts
- The list is for reference only. Due to limited time and resources, selectivity and prioritization will be necessary.

## Policy Menu for Supporting Industry Promotion (A tentative list for discussion)

Policy area	Measures
1. Capacity building (for specific firms)	<ul style="list-style-type: none"> <li>- Shindanshi (enterprise evaluation) system</li> <li>- TA for management and technology</li> <li>- Large-scale mobilization of retired Japanese engineers</li> <li>- Intensive support for limited sectors (e.g., die &amp; mold)</li> <li>- Awards, PR and intense support for excellent suppliers</li> </ul>
2. Human resource (general or institutional)	<ul style="list-style-type: none"> <li>- Management/technical centers and programs</li> <li>- Large-scale mobilization of retired Japanese engineers</li> <li>- Alliance between FDI firms and local universities/centers</li> <li>- Monozukuri school (to be upgraded to university)</li> <li>- Meister certification system</li> </ul>
3. Finance	<ul style="list-style-type: none"> <li>- Credit guarantee</li> <li>- SME finance institutions</li> <li>- Two-step loans</li> </ul>
4. Incentives	<ul style="list-style-type: none"> <li>- Exemption or reduction of taxes and custom duties</li> <li>- Grants or loans for specified actions</li> </ul>

## Policy Menu (cont.)

5. Linkage	<ul style="list-style-type: none"> <li>- Database and matching service</li> <li>- FDI-vendor linkage program</li> <li>- Parts Industry Association and Business Study Meetings</li> <li>- Trade fairs and reverse trade fairs</li> <li>- Linkage with Taiwanese suppliers (motorcycles, electronics)</li> <li>- Improving logistics between Hanoi and HCMC</li> </ul>
6. FDI marketing	<ul style="list-style-type: none"> <li>- Creation of strategic industrial clusters</li> <li>- Industrial parks and rental factories</li> <li>- Efficient logistics and infrastructure</li> <li>- FDI marketing targeted to specific sectors or companies</li> </ul>
7. Policy framework	<ul style="list-style-type: none"> <li>- Supporting industry master plan</li> <li>- SME law</li> <li>- SME ministry</li> <li>- Business associations and industry-specific institutes</li> <li>- Quality standards and testing centers</li> </ul>

## Steps Proposed by the Japanese Side

- Sep.2008 – Kick-off Meeting (Hanoi, hosted by VCCI) - **Done**
- Formation of 5 sub task forces to decide Action Plan contents – **Ongoing**
- Feb.2009 – Finalization of Action Plan
- Implementation:
  - End 2009 – Short-term actions
  - 2013 – Medium-term actions
  - 2020 – Long-term actions

Following mechanisms will be utilized:  
- VN-JP Joint Initiative Phase 3 (2008-09)  
- Bilateral cooperation after the conclusion of Vietnam-Japan EPA (very soon?)

