Industrial Policies as Determinant of Localization: The Case of Vietnamese Automobile Industry

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Abstract

Localization of locally produced products and increasing local content rate have become the leading interest of many nations, especially developing countries where production mainly limited at labor-intensive and low-technology products with low added value. Therefore, many countries have used various industrial policies of tax, subsidy, trade measures, antitrust enforcement measure, standard-setting policy, etc. aiming at localization of domestically-produced goods. Automobile industry is expected to become a pillar industry having positive effect on the Vietnamese economy. It produces technology-intensive, high value-added products, as well as is a motive to promote the development of material industry, fuel industry, painting, plastic and many other supporting industries. The research focuses on the relationship between industrial policy and localization on figuring out the various regulations that have possible effect on the localization. The research also discovers the real state of localization of auto products, causes of stagnation in the localization of vehicle products and role of current policies in localization. Both qualitative and quantitative research methods are utilized to understand responses of the automobile companies to the present policy and their demand on improvement of the policies.. Questionnaires and surveys will be distributed to automakers belonging to VAMA (Vietnam Auto Manufacturers Association) Vietnamese auto industry. Qualitative research will be next step of researching that helps clarifying responses as well as recommendations of the automakers and auto-part makers which are showed in questionnaires and survey.

Keyword: local content, localization, automobile, industrial polices.

I. INTRODUCTION

Localization of locally produced products and increasing local content rate have become the leading interest of many nations, especially developing countries where production mainly limited at labor-intensive and low-technology products with low added value. There arise the phenomena that in spite of increase in absolute amount of investment including foreign direct investment in many countries, their GDP and living standards are not improved. Therefore, many countries have used various industrial policies of tax, subsidy, trade measures, antitrust enforcement measure, standard-setting policy, etc. aiming at localization of domestically-produced goods.

Developing countries have used a mix of import protection, export promotion, foreign investment restrictions and performance requirements, tax incentives and other measures to promote industrialization and thus catch up with the other countries. These policies evolved over the past three decades starting with import substitution, which depends on the size of the country, has evolved into export orientation. Often, export-oriented polices will run parallel to import substitution policies as protection is only removed gradually. However, beginning in the mid-1980s, the increased need to attract FDI for technology and market access, pressures from major markets such as United States and Europe for market opening, reducing trade surpluses… led to greater deregulation and liberalization. So, the industrial policy, besides the initial purpose of promoting a certain industry or a subset of industries, also aims at encouraging the development of the industries to catching up with more developed ones in other countries and capable of competing with them.

It is realized that increase of investment in quantity is not enough to bring about the prosperity to the economy, improvement of investment in "quality" is extremely important. As mentioned above, investment in developing countries is mainly focused on labor-intensive, low-tech and low-capital products in order to take advantages of cheap production cost of land, workforce and environment, etc., so it is impossible to get much benefit from the investment, this phenomena may even hinder further investment in the future due to the limitation of internal production force. So, improvement of investment in terms of "quality" in order to raise added-value in products would bring about much more benefits of not only profits but also workforce, technology… and thus having a good effect on the economy. According to JETRO, local procurement of the manufacturing sector in 2004 was 47,9% in Thailand, 45% in Malaysia, 38,3% in Indonesia and 28,3% in the Philippines. Ohno (2007) write Vietnam's local procurement ratio was 22,6% in 2003[1]. Mori (2007) said that the average local procurement ratio of Japanese manufacturers in ASEAN 4 (Malaysia, Thailand, Indonesia, Philippines) rose from 41,9% in 1998 to 51,8% in 2003, the same ratio in China also rose from 46,8% in 1998 to 55,9% in 2003[2]. Especially, in the automobile industry, developing countries mostly utilize local content rate as a criteria to value the industry's success or failure. The ASEAN countries like Indonesia, Thailand, Malaysia, Philippines all have launched various policies in order to stimulate using local parts. Haryo Aswicahyono said that Indonesian government introduced deletion program in 1977 in order to force domestic car producers to use domestically produced components and give opportunity for supporting industry to growth. Simultaneously, domestic producers are required to increase local content gradually starting from universal components which were already produced domestically towards more specific and targeted components. The government's policy was once again changed in 1993 to an incentive program for stimulation of producers for using more domestic components. The national car program was approved to create a new framework for accelerating local content. Malaysian government also

[1] Kenichi Ohno, 2007, pp2

2 Mori Junichi, 2007, pp66

launches a National car program for increasing local content in 1980s. And Thai government also implements series of policy for localization. The other countries like Australia, India, Ukraine… all have pursued localization as a key point in their auto industry development.

Many industries in Vietnam including garment, textile, shipping, shoes, mechanics, electronics, so on are trying to take advantage from advantages available domestically in order to decrease production cost and increase their competitiveness. And localization occurs in many enterprises including foreign direct investment companies. It is increasingly using locally-produced products and materials as well as utilizing human resource,… The motorbike sector is the most advanced in localization, with local content rate of 70-80% in various kinds of models. In the electrical and electronics sector, local content rate is rising. In 2002, most electronic assemblers were unable to domestically source even relatively simple plastic and metal parts. Now, however, one TV assembler reports that it is able to buy virtually all plastic parts from (mainly) FDI suppliers in Vietnam. Local content rate of TV products is from 20% to 70% depending on each product. Similarity, a computer device producer said that it had increased its domestic suppliers from 7 to 45 in 2006. Local content rate of air-conditioners is up to 60%, local content rate of textile products is about 30%... However, there are some other producers remain low level of local content rate with CKD assembling only. Although the firm can achieve high local content rate in terms of number of parts, its localization rate remains low in value. This implies that localization has been concentrated in low-value parts. Ohno (2007)[3] said overall, the current localization level is still far below what the Japanese firm desire for attaining competitiveness. Even for manufacturers who have raised local procurement of plastic parts significantly in recent years, finding electronic parts, molds and metal process such as pressing, forging and plating remains very difficult.

This process is positively supported by the Vietnamese government with series of policies to encourage supporting industries and localization. Moreover, pressure of integration into ASEAN region (Association of South East Asia) under AFTA (ASEAN Free Trade Agreement), which forces Vietnam loosening its protection on various kinds of products and opening market for other countries, requires goods from Vietnam to gain certain ratios of localization rate to take advantage of ASEAN intra-trade and compete with goods of other countries. Besides that, localization is also useful in reduction of production cost, enabling raising competitiveness of goods under international orientation of regionalization and globalization. Therefore, utilization of industrial policy for increasing ratios of local-production of commodities is extremely essential.

Automobile industry is expected to become a pillar industry having positive effect on the economy. It produces technology-intensive, high value-added products, as well as is a motive to promote the development of material industry, fuel industry, painting, plastic and many other supporting industries. Increasing local content rate is the most important point in the governmental scheme of Vietnamese automobile industry development to the year 2010, in which local bus was planned to gain 40% local content rate in 2005 and 60% in 2010 (the localization rate of bus at present is 30 to 35%), luxury car was planned to increase to 20-25% in 2005 and 40-45% by 2010 (table1). And localization of locally-produced vehicles is interested by policy makers as well as public voice.

[3] Kenichi Ohno, 2007, pp3

Table 1. Government's scheme on local content of automotive products

	2005		2010	
	Local content rate	**Estimated production volume**	**Local content rate**	**Estimated production volume**
Bus	40%	15,000	60%	36,000
Truck	50%	40,000	65-70%	100,000
Car from 4 to 9 seats	30%	3,000	50%	10,000
Professional car	40%	2000	60%	6000
Luxury car	20-25%	32,000	40-45%	60,000
Engine	15-20%		50%	100,000
Gear box			90%	100,000

Source: Báo cáo về chiến lược phát triển ngành ô tô Việt Nam từ nay đến năm 2010, tầm nhìn 2020 trình thủ tướng chính phủ - Report on Strategy to develop the Vietnamese automobile industry to the year 2010, vision 2020 submitted to Vietnamese Prime Minister. Vietnamese Ministry of Industry.

However, after more than ten years from their establishment in Vietnam, these automobile companies all have no much progress in increasing local content, they mainly assemble vehicles with imported parts and components under CKD kits. And although the Strategy for development of the Vietnamese automobile industry was approved in October 2004 with much expectation from policy makers, there is no positive signal from automobile companies showing that they move toward increasing local content rate. This situation goes against expectation of Vietnamese policy makers and they are trying to break this stagnation.

Though not concrete theory has been developed on how industrial policy has possible effect on increasing local content rate, it has been strongly believed that owing to the apt policies from the host government, investors would be eager to locally source materials, parts and components, thus localization rate is able to be upgraded. Therefore, the *central issue* that I want to research on is the relationship between industrial policy and localization on figuring out the various regulations that have possible effect on the localization.

II. OBJECTIVES

Vietnam is on transitional economic process from central-planning economy in which government sets targets and the enterprises must implement it regardless of economic efficiency into market economy in which enterprises must be self-planned self-expense calculated for profit. So, there still exists a gap between policy makers and enterprises, in which many targets set by the government are not accepted by the enterprises. The research would like to look into the current situation of localization in the auto industry from the point of view of business side to assess real state of localization, effect of the policy, hoping that pointing out some matters of localization of locally-produced vehicle in Vietnam and how to utilize industrial policy to deal with the matters.

III. LOCAL CONTENT AND INDUSTRIAL POLICY

Local content or localization is defined as "added value" of products processed domestically. It refers to the proportion of products that is not imported.

Local content rate or localization rate is defined as percentage of “added value” of products processed domestically.

So, the “added value” of products is not merely percentages of parts or components contributing to the finished products, but it includes quality, human resources, technology and so on that are processed domestically.

“Domestically” means a specified geographic locality, maybe a village, a prefecture, a country, a region… and in this study “domestically” means inside a country.

The “added value” of products can be understood as added real or nominal cost to produce the products, added value in real or nominal price of products. Each country has its own way of defining local content rate. It usually uses local content rate by value or local content by point list.

Local content rate by value

$$\text{Local content rate (\%)} = \frac{\text{Manufacturer's price} - \text{(import price CIF)}}{\text{Manufacturer's price}} \times 100\%$$

At present, the countries in the world now tend to use calculation of local content rate by value, for example China, Thailand. However, each country has its own differentiates, for example, Chinese refer import price CIF to the price in 1985. However, this method requires a control in price of inputs in order to avoid fraud in local content rate,

Local content rate by point list: Each component or groups of components is assigned a certain point which is then used as a count of local content used by manufacturer. The local content rate by point list assures that the enterprises will get the same local content rate if they source the same parts locally or invest in the same production stage. Each country can regulate different percentages for one parts or production stage… For example, Indonesia regulated that assembly has 10 percent of value added raw material generally have 20 percent added value, an automotive product which all of its components are manufactured locally except raw material and its design and engineering which come from brand holder have a maximum of 75 percent local content rate.

However, when calculating the local content rate of each single parts and components, they apply the formula:

$$\text{Local content rate (\%)} = \text{\%value added achieved x given weighted \% of parts}$$

Vietnam now applies calculation of local content rate by point list for automobile. Auto parts are divided into 100 groups of parts and each group is assigned a certain local content rate. The auto parts that are sourced from other local autopart companies are understood as parts produced by the automobile companies themselves. In order to calculate local content rate, automobile companies must submit a declaration of their production stage or parts source locally. In the case products are processed domestically from imported semi-products, local content rate are calculated basing on value added of parts or part group. For the components inside the parts, local content rate by value are applied. At present, if a companies import all the parts and components to assemble locally, only painting, welding, stamping operated locally can be calculated 12 percent local content rate.

Industrial policy and local content increasing

Industrial policy can be defined as the wide range of government actions designed to promote growth and increase the competitiveness of a particular sector or sectors in an economy.

Industrial policy refers to any policy that affects an industry or a subset of industries (Hart, 2001)

Given this definition of industrial policy then any tax, subsidy, trade measures, antitrust enforcement measure, standard-setting policy, etc., that affects industries differently can be considered an industrial policy.

Developing countries have used a mix of import protection, export promotion, foreign investment restrictions and performance requirements, tax incentives and other measures to promote industrialization and thus catch up with the other countries. These policies evolved over the past three decades starting with import substitution, which depends on the size of the country, has evolved into export orientation. Often, export-oriented polices will run parallel to import substitution policies as protection is only removed gradually. However, beginning in the mid-1980s, the increased need to attract FDI for technology and market access, pressures from major markets such as United States and Europe for market opening, reducing trade surpluses… led to greater deregulation and liberalization. So, the industrial policy, besides the initial purpose of promoting a certain industry or a subset of industries, also aims at encouraging the development of the industries to catching up with more developed ones in other countries and capable of competing with them.

John Humphrey and Antje Oeter (2000) asserted that it is necessary to issue a policy aiming at creating a domestic automobile industry capable of competing in a future, more liberalized environment, and the policy must satisfy three tasks: first of all, defining an "automotive space" which is protected by policy measures acceptable to trading partners. Secondly, ensuring that the domestic automobile industry competitive within the space and able to attract foreign direct investment. Thirdly, preparing the domestic automobile industry for a more liberalized trading environment.

The automobile industries in ASEAN region seem to follow the same route. Starting with import substitution, in which individual domestic markets are protected to encourage local production and import substitution is being removed gradually with the introduction of export orientation. Thai automobile industry was ready for regional liberalization and prepared well for international competition; Indonesian automobile industry exposed to deregulation and liberalization under pressure from International Monetary Fund; while Malaysian automobile industry is successful in domestic market, but stagnates in export.

Local content increasing is the hallmark of a number of countries as they tried to develop large-scale industries with externalities. In particular, automobile industries around the world have been heavily dependent on various polices for increasing local content (Bora, 2001). Many countries in the world have pursued localization in order to build up the automobile industries including Australia, India, Thailand, Malaysia, Indonesia, etc. They have applied different policies to promote local content such as a high tariff on imported automobiles, CBU import ban, import quota; a government subsidy of funds, tax and tariff preferences, land… to the automobile industry and so on. The introduction of local content requirements was the driving force behind local sourcing. In the 1960s, a few Japanese automobile companies had already set up operation in the ASEAN region but the local supply of parts was not on their agenda. However, during the 1970s, the ASEAN countries adopted measures to promote local sourcing. For example, local content legislation was introduced in 1972, with locally assembled vehicles having to source 15 to 25 percent of their content locally if they were remain to exempt from import tariffs. This requirement rose progressively, reaching 54 percent for high volume vehicles such as pickups and passenger cars. Given the shortcomings of the local industrial base, it would have been impossible to meet the required local content by sourcing solely from locally owned firms. Therefore, local supply was achieved through new investment by Japanese autopart companies and technology transfer agreement that often turned into joint ventures. Many technology transfer agreement were sighed in the 1980s and this trend has accelerated since.

Since the 1960s, import-substituting industrialization supported by the infant industry argument has come under increasingly harsh criticism. Especially in recent years, the global move towards liberalization is gradually freeing up the flow of capital and products, and emerging markets are slowly being integrated into the global network of automobile industry. At the same time, however, many developing countries are still concerned about protection of domestic industries which are not ready to compete with global players, and they are exerting countervailing force against liberalization. Mai Fujita said that in this sense, the current move toward liberalization can be understood as a test of success or failure of past industrial policies in developing competitive domestic industry.

IV. OVERVIEW OF VIETNAMESE AUTOMOBILE INDUSTRY

4.1. Vietnamese automobile industry

Prior to 1991, Vietnam import cars mainly from the socialist countries or import chassis from German Democratic Republic to build buses of 46-50 seats. There were no domestic companies invested in synchronous car assembly line. The main tasks of automobile companies only repaired imported vehicles.

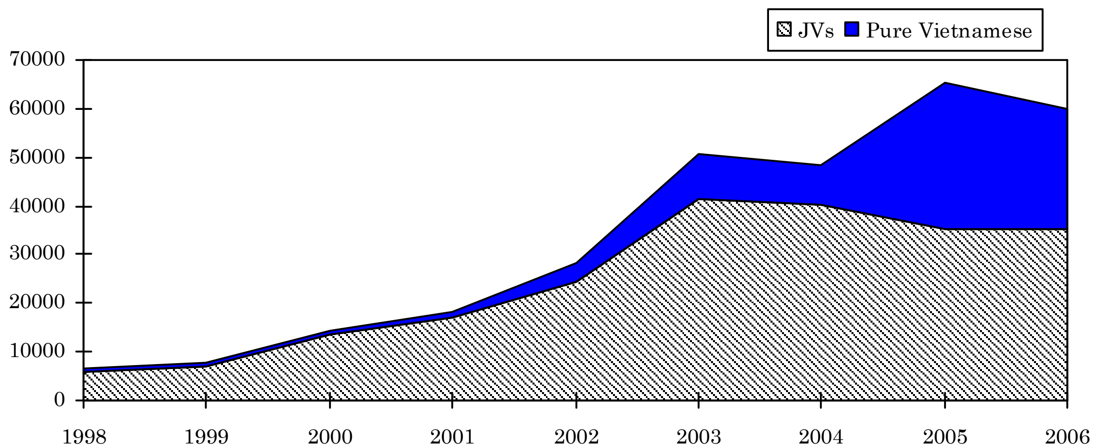
Since 1991, the Vietnamese automobile industry has begun to change dramatically owing to the open policy of Vietnamese government in which incentive policy for automobile industry was gradually taken shape. In 1991, Auto Hoa Binh formed a joint-venture partnership with Philippines, called Vietnam Motors Corp. (VMC) and up to now, there are 12 automobile joint-ventures in Vietnam including seven Japanese automakers (Daihatsu, Hino, Isuzu, Mitsubishi, Suzuki, Toyota and Honda[4]), one Korean automaker (Daewoo), one Korean-backed license assembler (Mekong), one Philippine-backed license assembler (VMC), one German automaker (Mercedez), and one American automaker (Ford). Joint ventures are capable of manufacturing any kind of vehicles demanded by domestic market, but Hino Motors is only specialized in heavy trucks. There are more than 40 foreign autopart companies and 100 domestic companies including 20 CKD kits assemblers and repairers, 20 body-trailer-barrel builders and 60 part manufacturers (Report from Ministry of Industry).

The pure Vietnamese automobile and autopart companies in Vietnam mostly were established since 1960s, some of them joint venture with foreign invested automobile companies in order to found Joint ventures as mention above, the others specialized in assembling some certain kinds of vehicles such as truck, bus, commercial cars under simple production line (welding, painting, assembling…) from imported chassis from SNG and China, but they are quite independent and loose in mutual cooperation. Total asset of each

[4] Honda Vietnam received investment license on March 2005 and start its operation in this year. Therefore, in this research automobile joint ventures refer to 11 joint ventures excluded Honda Vietnam.

companies generally is small, about VND20 billion (about USD 150,000). However, recently, especially in 2004, many 100% domestic investment capital companies including private and state own enterprises were launched, for example Truong Hai auto companies invested in producing Kia and Huyndai with investment capital of USD 330 million, TMT corporation invested USD 250 million manufacturing pickup trucks… Majority of them import production line and technology from China and competition among enterprises are raising. The main local automobile companies include Vietnam motor corporation (Vinamotor), Saigon auto-mechanics Corporation (Samco), Vietnam Engine and Agriculture Machinery Corporation (VEAM) and Vietnam Coal Corporation (Vinacoal), they all are state own enterprises. Recently, some private domestic investors invested in automobile industry but mainly vehicle assembly rather than parts manufacture. In general, pure Vietnamese automobile and autopart companies face with difficulty because they must be in charge of production of vehicle and autopart and more independent in economic planning that they did not implement.

Figure 1. Structure of auto production volume



Source: Báo cáo về sản lượng bán hàng theo ngành hàng-Report on sales classified by industries. Ministry of Industry

Table 2. List of automobile joint venture in Vietnam

Company	Home Country	Company Type	Start Date	Location
Vidamco (Daewoo)	Korea	Automaker	1995	Hanoi
Vidaco (Daihatsu)	Japan	Automaker	1996	Hanoi
Mercedez	Germany	Automaker	1996	HCMC*
Ford/Mazda	USA	Automaker	1997	Hanoi
Hino Motors	Japan	Automaker	1997	Hanoi
Isuzu	Japan	Automaker	1997	HCMC
Mekong (Fiat, Iveco, S-Young)	Korea	License Assembler.	1992	HCMC
Vinastar (Mitsubishi)	Japan	Automaker	1995	HCMC
Visuco (Suzuki)	Japan	Automaker	1998	HCMC
TMV (Toyota)	Japan	Automaker	1996	Hanoi
VMC (BMW, Mazda, Kia)	Phillipines	License Assembler.	1991	Hanoi
Honda	Japan	Automaker	2005	Hanoi

Note: *HCMC means Ho Chi Minh City, the biggest city of Vietnam. These joint ventures located inside and around Hanoi and Ho Chi Minh City

Source: Compiled from various newspaper and websites of automobile companies

Eleven joint ventures now play key role in Vietnamese automobile industry (Table 2). Most of them were established from 1995 to 1998, when the government allowed more automobile companies invest in Vietnam. Before 1995, there were only VMC and Mekong selling cars. Production volume of eleven joint ventures have accounted for majority of more than 90 percent of domestic market. (Figure 1)

They are diversified in production, being able to produce any kinds of cars to satisfy domestic market demand and only Hino Motors Company specialized in heavy-duty truck. However, from establishment, the joint ventures have mainly concentrated on passenger cars serving for high income residents. To the year of 2002, 11 JVs have assembled 78,394 vehicles, achieved USD 1 831.933 million in sales, delivered USD 305.951 million in tax, employed 3814 workers and got profit of USD 24.413 million.

Registered investment capital of 11 joint ventures is USD 574.7 million and total real investment to the year 2002 was USD 419.85 million accounting for 74% registered investment capital. Honda Vietnam was approved to invest in producing cars in 2005 and increase their investment capital to USD 209.2 million from USD 151,2 million (Before 2005, Honda focus on motorbike manufacture)

The production volume of vehicles remains at low level smaller than 100.000 units per year, but it consecutively increases annually. In 1996, total production volume of Vietnamese automobile industry was only 5538 vehicles, however in 2000, automobile company could produce 14,655 units and production volume of 2003 achieved 47,553 vehicles.

However, JVs just used average capacity of 30% out of total capacity. In 2003, Toyota Vietnam with largest share of 27.7% only sold nearly 12,000 units. These joint ventures are producing far below their capacity, total capacity of 11 JVs is about 149.000 units per year but sale volume in 2003 achieved 42,557 units. For the capacity utility of 12 joint ventures, only 3.7% of the capacity was used in 1996, from 2000 it seems to increase faster got 13.2%, 18% and 28.8% in the year 2001, 2002 and 2003 respectively. It is very clear that capacity utilization rate in Vietnam automobile industry is extremely low and Joint ventures all look toward to the prosperity of high growth rate of Vietnamese domestic automotive market to invest in building up their factories in Vietnam.

Vietnamese automobile industry have experienced more than 10 years and gaining some modest achievement, however it is still in the early of infant stage of assembly with low value-added products. The Vietnamese automobile industry must cope with many difficulties of investment, production, market, localization, and so on, out of which local content rate increasing is considered as the decisive point that have effect on the other problems of price, development of the automobile industry, auto parts production and so on

4.2. Policy for the Vietnamese automobile industry

Localization is expectation of policy makers since the initial years of calling for foreign direct investment to the Vietnamese automobile industry. It was concretized in local content requirements regulated in investment license. The Vietnamese government created favorable conditions for the automobile industry in order to support automobile companies in their progress of localization and development of automobile industry. It could be said that the automobile industry have received much incentive and priority from the government, however, from 2004, policy changes toward decreasing protection.

Protection (1990s-2003)

The pure Vietnamese automobile and autopart companies have not yet been strong enough to be able to found an automobile industry, so since the early 1990s, the government decided to attract more foreign investors to establish their production base in Vietnam. The government has offered much priority for the automobile industry under high-domestic-market protection and high incentive policy. Additionally, slight local content requirement was applied on the base of commitment signed between Ministry of Planning & Investment and foreign investors when investment licenses were granted.

Various incentives were offered to the automobile companies for attracting investment and creating market for the local products. The automakers are required to have local partner-usually state own enterprises, which typically contribute 30% of investment in land and factories and have representatives on the joint ventures' boards of directors. Automobile companies are exempted from income tax for the period of 4 years, exempted from import tariff of equipments, machines, material for fixed assets that have not been domestically produced, exempted from value-added tax, get 50% decrease in income tax for 8 years since making profits, get preferential income tax of 15% to 20% depending on their location (income tax is normally 25%). The domestic market is protected by more priority for the locally produced products, a high import tariff of 300 percent are levied on CBU (complete build up), high special consumption tax is imposed on vehicles import while the local ones only suffer 5 percent, value-added tax also adds more on the price of imported vehicles while parts and components imported for local assembly only suffers a far lower tariff. For example, for the under-5-seat car, CBU import tariff is 100%, while CKD (complete knock down)import tariff is only 20% and IKD (incomplete knock down) import tariff is 5%, special consumption tax on CBU import is 100, whilst domestically-assembled products is only 5%. All these preferential taxes and tariffs make locally-produced vehicles are protected up to 300%, making an import ban on CBU unnecessary. Obviously, imported brand-new vehicles have an extremely small opportunity in Vietnamese market and consequently domestic market is mainly for local assemblers.

However, up to now there is no joint venture sourcing more than 10 percent of local parts and components. There are some pure Vietnamese automobile companies manufacturing buses and trucks achieving high local content rate.

The government encourages foreign investment in parts and components production and allows 100% foreign-capital autopart companies invest in Vietnam (normally foreign automobile companies are asked to joint venture with local firms with capital contribution of less than 70 percent). Moreover, the government impose high tariff on imported parts to protect local autopart companies and also gives incentive to local autopart companies. The local autopart companies pay low imported tariffs of components, materials or accessories using for part assembly.

Together with incentives, Vietnamese government also asked all joint ventures commit to improve the local content rate in the local produced vehicles. According to the commitment signed between joint ventures and the Ministry of Planning and Investment, joint ventures must increase local content rate to 5 percent by the fifth year of operation and 30 percent by the tenth year of operation.

With high protection and high incentives, as a result within several years from 1991 to 1998, 11 World automobile companies have come for establishment of their own production base in Vietnam, 40 foreign-invested autopart companies, as well as 20 local CKD kits assemblers and repairers, 20 body-trailer-barrel builders were developed. However, localization rate remains very low.

Protection decreasing (from 2004)

After long time of high protection since 1990s, there is a little progress in localization. That all JVs don't increase localization rate as committed, together with high price of cars goes against the government's expectation, so the government decided to decrease protection since the year 2004.

Since January 1st 2004, locally-produced vehicles have been imposed another 5 percent of imported tariff of parts under CKD set. Simultaneously, special consumption tax for local vehicles rose from average level of 1.5 -3 percent to 7.5-24 percent.

Since 2004 tax remission rate would decrease, before the year 2004 local companies got 95% tax deduction, this rate fall to 70% on 2004 and 50% and 30% on 2005 and 2006 respectively. Moreover, from 2006 local companies cannot be exempted from value-added tax, they all must pay 8 to 10% value-added tax as imported ones. Additionally, government increase import tariff on CKD kits in order to encourage local production of parts and components. Import tariff on CKD kits will increase to 25% in 2004 and 36% in 2006. So, by the year 2007, tax and tariff protection will be decreased by around 100 percent for the car under 5 seats (including 70 percent added from special consumption tax, 8-10 percent from VAT and 16 percent from tariff of parts import).

The government also decided not to impose tariffs on CKD set as before 2005, instead of it, tariffs on separated parts will be applied and high import tariff on parts, which are able to sourced locally are imposed in order to encourage using local parts. The new local content rate calculation issued by the Ministry of Science and Technology improved method of point calculation list in which all parts and components are divided into one hundred groups of parts and each group is assigned a certain local content rate. The auto parts that are sourced from other local autopart companies are understood as parts produced by the automobile companies themselves. In the case products are processed domestically from imported semi-products, local content rate are calculated basing on value added of parts or part group. For the components inside a part, local content rate by value are used

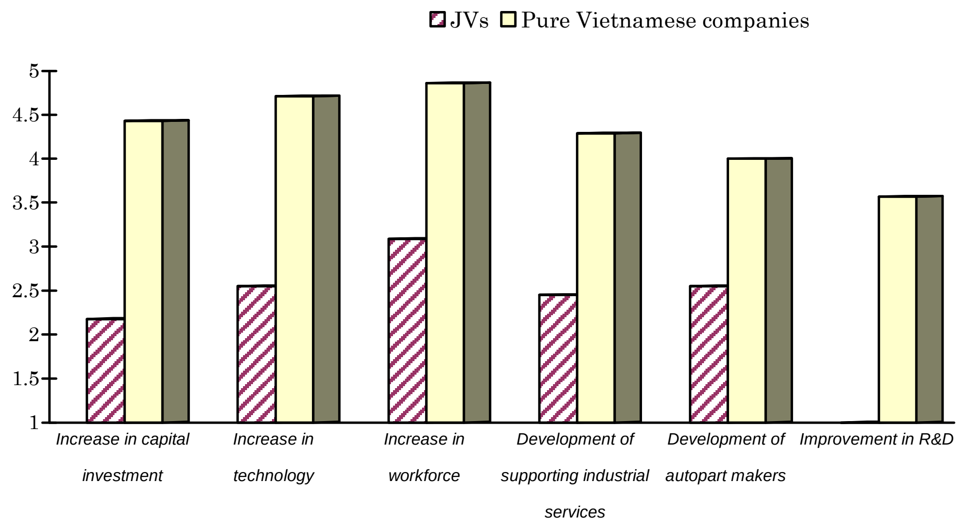
On March 2005, Ministry of Finance submitted to the Prime Minister new tariff program on auto parts, in which the parts and components that are being produced locally or need to be encouraged locally will be imposed the reasonable protection tariffs of not higher than 30 percent. The most-protected parts will be bodywork, interiors, tires, tubes, batteries…which are advantages of Vietnam now.

V. LOCAL CONTENT IN VIETNAMESE AUTOMOBILE INDUSTRY

Chart 1 represents assessment of automobile companies of current localization of domestically-produced auto products in Vietnam, showing opinions of joint ventures and pure Vietnamese companies. It seems that there is growth in criteria all including capital investment, technology, workforce, supporting industrial services, autopart makers. However, there is mostly no much improvement in R&D, JVs even rate it 1, meaning that neither investment nor progress in R&D. In all joint ventures, there are no R&D sections in their companies, they only buy designs from their related companies located in the region.

Among localization criteria, workforce is highly appreciated owing to characteristics of hard-working, skills, patience, creativeness, high education, besides that is foreign language. In many joint-ventures, foreign partners chiefly hold executive position while local staffs are good at various positions, even in most joint ventures, there are no foreign technicians in the factories, 100% workers in the production base are Vietnamese people. In pure Vietnamese companies, technology transfer with no capital sharing with foreign companies is preferred to joint investment. Managers and staffs in all companies asserted that Vietnamese workers can control technology well and they can independently work and create.

Chart 1. Development level of each localization criterion



Source: Research results

However, there exists gap among ratings of pure Vietnamese companies and joint ventures. Pure Vietnamese companies seem to be more optimistic than the joint ventures. While pure Vietnamese companies gave high grade to all localization criteria, joint venture rated lower. In fact, the pure Vietnamese companies including long-operated state-own enterprises and private companies have experienced a deep and quick change from central-planning economy to market economy under the reform policy of Vietnamese government, so it could be said that changes in the auto industry are highly valued. However, under the eyes of foreign companies, the pace is slow and there is no motivation showing that progress will be upgraded.

For the technology, automakers mainly import assembly line from abroad and then train local workers to do assembly rather than focusing more deeply on production. There are some automakers invest more to part assembly for example Mitsubishi, Honda, Toyota rather than only car assembly. However the investment is still limited; Vinaxuki-a pure Vietnamese automakers also invest more in forging, molding, engine assembly too, some state-own enterprises have plan to produce transmission and engine under technology-transfer contracts.

The pure Vietnamese auto makers and autopart makers is clearly easier to source more component, materials in the local market because their requirement of quality, delivery is not too tough, however, JVs seems extremely difficult to find one, even they try some. Supporting industry is just able to meet with requirement of some local companies, and unable to supply to foreign invested ones.

For the capital, there are still many companies including automakers and autopart makers desire to invest in Vietnam. However, up to now, only automakers eager to register in Ministry of Planning and Investment for investment licenses, the autopart makers remain hesitated investing in.

Table 3. Local content rate of automobile Joint ventures

	Automobile companies	**Brands**	**Local content rate (%)**
1	Toyota Motor Vietnam	Toyota	20*
2	Ford Vietnam	Ford	6,45
3	Vinastar Motor	Mitsubishi	14
4	Isuzu Vietnam	Isuzu	12*
5	Vietnam Suzuki	Suzuki	10
6	Vietnam Daewoo Motor	Daewoo, GM Daewoo	8
7	Mercedez-Benz Vietnam	Mercedez-Benz	1.5
8	Honda Vietnam	Honda	20*
9	Vietnam motors corporation	BMW, Mazda, Kia	12*
10	Hino Motors Vietnam	Hino	2,06
11	Vietindo Daihatsu Automotive	Daihatsu	4
12	Mekong Auto	Fiat, Iveco, SsangYoung	4.6
13	Saigon Transportation Machinery Corp.	Samco	40
14	Truong Hai Auto Corp.	Kia, Daewoo, Foton, Thaco	40
15	Vietnam Engine Agricultural Mechinery Corp	Veam	40
16	Vietnam Coal Corp.	Kamaz, Kraz	35
17	Xuan Kien Private Enterprise	Vinaxuki	60*
18	Vietnam Motor Industry	Vinamotor	40*

Note: * data from the field research on March 2007, the other ones are from a report of Ministry of Industry in 2006.

Source: Báo cáo về ngành ô tô Việt Nam - Report on Vietnamese automobile industry from Vietnamese Ministry of Industry and field research

Table 3 shows us local content rate of 18 automobile companies belonging to VAMA. It is realized that joint venture listed from number 1 to number12 achieved modest local content rates, mainly less than 10%. Toyota and Honda are the best among Joint ventures with local content rates in some products gained 20%. While pure Vietnamese companies achieved higher local content rate from 35% to 60%.

Most of joint ventures source modestly local parts mainly interior parts. Toyota Vietnam presently source locally wire harness, seats, exhaust pipe, battery, cassette, stamping, break oil pipe, seat ankle, mudguard, air bag… together with assembling, painting gained from 13 to 20% local content rate on various cars. VMC imported everything needed for assembly under CKD1 and CKD2[5] sets and nothing was sourced locally, it also imported separate components and equipments such as seats, airbags, transport racks, leathers, side

[5] CKD1- Complete knock down level one means All parts imported Painting done in Vietnam
CKD2 - Complete knock down level two means All parts imported, body welding and painting done in Vietnam

protectors & flaps. Daewoo also source locally no parts and components, CKD sets were imported for assembly from Korea.

Joint ventures all focus on producing passengers of high price and serve high income people. For their purpose of assembling brand-new auto, complete sets of auto parts and components are imported from parent companies or their suppliers. Local content added in the production process is quite low mainly bodywork welding, painting (electrostatic painting is only used in some companies like Toyota, Ford, Mitsubishi, and the other assemblers must rent or do not use electrostatic painting technology) and assembling & testing. There are no joint ventures sourcing auto parts and components from pure Vietnamese companies, a few locally produced parts and components with low added-value produced by foreign invested autopart companies such as batteries tires, seats, electric wire, antenna...were tried by joint ventures, however, only some were accepted and even they were sourced by a automobile companies, they may not satisfy standards of the others.

For the pure Vietnamese automobile companies, their targeted market is low price vehicles with buses, small and mid-sized trucks and professional vehicles, so they can accept more locally produced parts and components. Moreover, the state own automobile companies have to implement the tasks assigned by the government of localization and they are backed financially by the government to increase local content and many of them have participated in the governmental projects of localization. Their products mostly are bought by the state own transportation companies and other state own enterprises, hospital... Therefore, they achieved higher local content rate.

To date, the local content in the automobile products remains very low, achieving from 2 to 20 percent for passenger cars and 20 to 60% in bus, light lorries, minivan, pickup trucks. The problem here is that joint ventures that are placed most expectation from the government and get much priority and incentives are not aggressive to localize, while pure Vietnamese automobile companies who mostly invest in bus and pickup trucks, which are not got much incentive gained higher local content rate of 30 to 60%. Saigon Motors Corporation (Samco)-a pure Vietnamese automobile company produces buses, postal vehicle, ambulance, fire truck of 35 percent local content rate. Mekong and VMC automobile companies have more than 12 years in operation in Vietnam but VMC only achieves 12 percent local content rate with painting and welding, while Mekong only gained 4.6 percent. As regulated, joint ventures must increase localization rate to 5% by the fifth year of operation and 30% by the tenth year of operation, so eleven joint ventures are expected to achieve 25 percent local content by 2006. However, local content rate of Toyota Vietnam (TMV) who has highest sales in Vietnam and experienced 11 years of operation from 1996 only achieved more than 20 percent

Isuzu Vietnam after 4 years in operation achieve local content rate of 12 percent, in which mainly includes bodywork stamping, tires, exhaust pipes, paints and batteries. Field research to some joint ventures in Vietnam (Vidamco, Toyota Vietnam and VMC) showed that they did not source any local parts except for Toyota Vietnam, which started investment on bodywork stamping for 2 kinds of cars in March 2003 and air bag in 2004. VMC imported everything needed for assembly under CKD1 and CKD2 sets and nothing was sourced locally, it also imported separate components and equipments such as seats, airbags, transport racks, leathers, side protectors & flaps. The data collected from Vidamco (table 4) shows that there was no parts and components sourced from the local companies, CKD sets were imported for assembly from Korea. Although Vidamco tried to use local parts but they did not satisfy its standard or were much more expensive than import from mother companies. Therefore, its localization only includes assembly and painting (using paints of

ICI[6])

Table 4. VIDAMCO's operation

	2000	2001	2002	2003	2004
Locally-sourced parts	0	0	0	0	0
Imported CKD sets	2,051	3,144	3,216	4,448	4,872
Production volume	1750	2906	3719	5349	5,734
Sale volume	1,550	3,106	3,719	5,349	NA
-Passenger car	1,548	2,884	3,503	5,174	5,112
-Bus	2	22	216	175	NA

Note: NA means not available

Source: Field research to Vietnam Daewoo Motor Corporation on March 2005

Joint ventures focus on producing high price cars mainly passengers (some produce trucks too such as Mitsubishi or Hino but their products can not be profitable and difficult to compete with local trucks) and serve high income people. For their purpose of assembling brand-new auto, complete sets of auto parts and components are imported from parent companies or their suppliers (figure 2 shows import of parts and components by country). Local content added in the production process is quite low mainly bodywork welding, painting (electrostatic painting is only used in some companies like Toyota, Ford, Mitsubishi, and the other assemblers must rent or do not use electrostatic painting technology) and assembling & testing. There are no joint venture sourcing auto parts and components from pure Vietnamese companies, a few locally produced parts and components with low added-value produced by foreign invested autopart companies such as batteries tires, seats, electric wire, antenna...were tried by joint ventures, however, only some were accepted and even they were sourced by a automobile companies, they may not satisfy standards of the others.

For the pure Vietnamese automobile companies, their targeted market is low price vehicles with buses, small and mid-sized trucks and professional vehicles, so they can accept more locally produced parts and components. Many of them said that localization helps them much in lowering production cost, so their car prices are much more reasonable than JVs. That is why JVs face with difficulty when competing on bus and truck products. A manager of a pure Vietnamese companies said that their bus is only one-third of price in comparison with JVs' products and their bus completely manufactured by Vietnamese workers under a transfer contract with Huyndai.

Despite the government's pressure, joint ventures asserted that they can not increase local content rate and that price of cars will be even much higher if they are forced to produce parts locally by themselves. In fact, since the early of 2005, pleading on increase in special consumption tax for five-seat cars from 24 percent to 40%, automobile companies all adjusted price. Mercedes C240 rises from USD 69,000 to USD 81,000; Toyota Vios increases to USD 27,000 from USD 24,800. The price of cars increases one and a half times in comparison with that of 2003 after value-added tax and special consumption tax are applied. VAMA (Vietnam auto manufacturers association) said on Economics Times that "There are no automobile manufacturers being able to produce a car with all 30.000 parts. Because of present small market (only one-tenth in comparison with Thai automotive market), manufacturers are incapable of investing in parts and components in Vietnam."

[6] ICI is a foreign autopart companies

At present, there are 50 projects of foreign automobile companies waiting for investment licenses at Ministry of Planning and Investing such as Chinfon, JRD Motor Vehicle Assembly co., Ltd. and so on. Especially, they all assert that they will implement localization as requirements in the Strategy for Vietnamese automobile industry to the year 2010, 2020 issued on October 2004. Honda has just been accepted to invest in producing cars on March 2005 and Honda committed to gain 20 percent local content in the first year of operation and 40 percent by 2010. It is possible that the appearance of Honda Vietnam will warm the other joint ventures' efforts.

VI. FACTORS OF LOCALIZATION

It is clear that achievement in localization is far lower than the government's expectation and there is no positive signals showing that they can move forward quicker. However, it is impossible to blame for the automakers that they do not desire to improve local content, localization depends on various factors. And the following four factors: market, autopart industry, cost and quality.

1. Market

Market is extremely important reason resulting in stagnation in localization, both joint ventures and pure Vietnamese automakers mark it top cause. Up to now, all automakers focus on domestic market, there is no one of them export products.

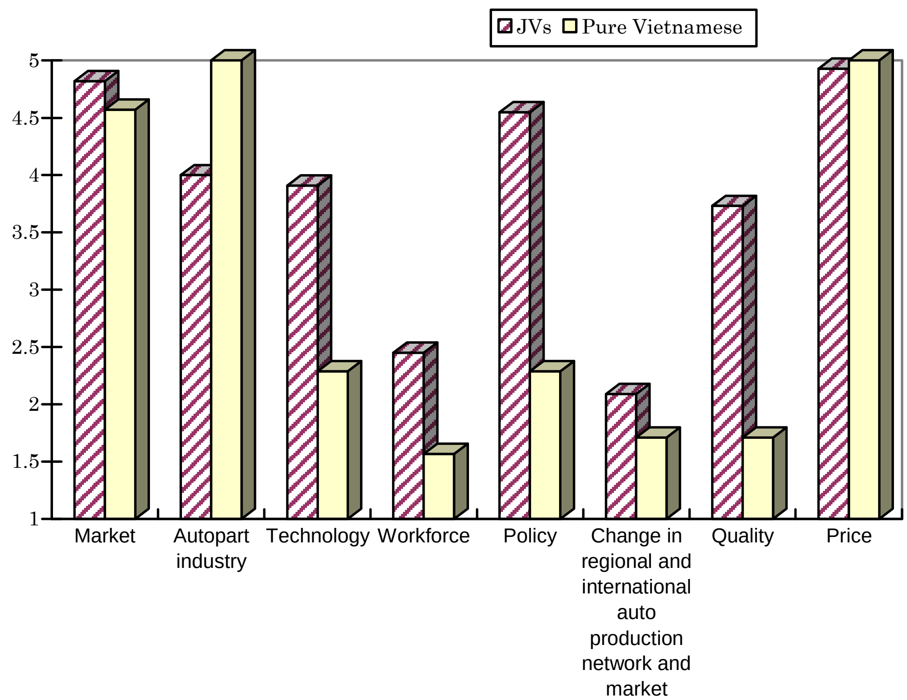
Now looking at the domestic market, the small demand caused by low income, poor infrastructure, too many models, high price of car… As could be seen in the Figure 1, along the time annual sale volumes have never exceed 70.000 units, so automobile industry has not yet taken advantage from economy of scale (usually, an automobile industry can only take off when sale volume overcome 100,000 units). Domestic vehicles are primarily sold in the big cities of Vietnam where majority of high-income residents live in and thus automobile companies chiefly supply high-price and luxury cars. A large percentage of Vietnamese people living in the rural areas get low income incapable of buying a vehicle for their transportation or production. GDP per capita of Vietnam in 2006 was USD 500[7]; it is not high enough to encourage the domestic demand. Government agencies and business corporations, including foreign-invested companies, are the main automobile purchasers; Vietnam has not yet reached the stage at which ordinary consumers can afford luxury items such as automobiles. Moreover, Vietnam's road, street, and highway infrastructure is in such poor condition that it is already reaching the limits of its carrying capacity. Traffic flow problems are very acute in Hanoi, Ho Chi Minh City, and along the roads and highways connecting the country's large cities. Private houses are not prepared for parking lots because they were built long time ago or/and in small areas. Imported CBU vehicles including second-hand ones added more pressure of competition to domestically-produced vehicles. In 2005 domestic automobile companies sold 65.500 vehicles but there are up to 17.460 old cars being imported, and the imported vehicles in 2006 were 12.619 which accounted for a big percentage in vehicle sales[8]. Moreover, pace of market expansion has been more gradual than what was originally anticipated in the early 1990s. For example, one foreign think-tank predicted in 1992 that domestic automobile sales would exceed 40,000 units in 1995, and 80,000 in the year 2000, however to the year 2001; the total sales achieved

[7] World Bank indicators, 2006

[8] Data from "Báo cáo về lượng ô tô đang lưu hành ở Việt Nam của Bộ Công An và doanh thu bán ôtô của Bộ Công Nghiệp Việt Nam" - Compiled from Reports on automobiles in circulation from Vietnamese Ministry of police and and vehicle sales from Vietnamese Ministry of industry.

50,062 units and local automobile companies could sell 32,259 units. The other matter is the large number of makes on sales, there are around 90 car's and SUV's models, 70 bus and truck's models[9], each model has its own design, standard of parts and components, they cannot be suitable for all models, so making localization more difficult. Automobile assemblers are trying to boost their market share by increasing the makes of vehicles that they sell, as a result sale per make which were already low have now fallen even further.

Chart 2. Causes of localization stagnation



Source: Research results

So, with the small demand of car in domestic market, demand of parts is also proportionally small and as a result automakers face with difficulties in finding autopart makers fit with their requirement. Moreover, small domestic demand of autoparts is made more serious when it is separated for unstandardization of autoparts, many models and different requirement of automakers.

Up to now there is no standard in Vietnamese automobile industry. So each company has their own standard, and autopart makers also produce parts with their own standard. That is why products of one autopart maker are only able to meet with requirement of one or some automakers. Of course, Japanese companies usually have their own part suppliers which only provide their typical parts to them, however, under present the situation of domestic demand, unstandardization make market separated.

The situation makes autopart makers divided into two kinds, one is high-ranking

9 Ministry of industry

companies which include mainly foreign-invested autopart makers supply to JVs and export, the other is local autopart makers without foreign-invested capital who mainly supply to pure Vietnamese automakers.

Many autopart automakers asserted that to start production in Vietnam, they need to be guaranteed a minimum sale of output, otherwise it would be very difficult for them to survive.

2. Autopart industry

The automobile industry is *lack of part and component suppliers*. There is no automobile companies being able to produce all parts and components for a car, they can only produce at most 36-42 percent of the car, the other parts out of 20,000 to 30,000 parts and components of a car must be bought from thousands of autopart companies. However. there are a small number of foreign autopart companies investing in Vietnam, to date, there are totally more than 100 autopart companies including pure Vietnamese ones and foreign invested ones. Ordinarily, "a carmaker needs at least 20 autopart suppliers with various parts and components"[10.] Vietnam has 11 JVs and 20 pure Vietnamese automobile companies, so the automobile companies in general have only two or three domestic autopart suppliers. These number of autopart companies are too small to provide parts and components to the assemblers. Moreover, the automobile industry faces with the lack of supporting industries. The final products in the automobile industry require various kinds of supporting industries and the later are quite important for the development of the former. Supporting industries cover a very wide range of parts and components used in assembly of final products through the supply of parts and components or immediate goods. Materials for locally produced parts and components such as steel ingot and steel plates... must import because domestic companies have not yet been able to produce. Moreover, the auto parts suppliers only concentrates on labor-intensive and low technology products, so locally-produced auto parts are not diversified.

Additionally, there exists difference in market share between JVs and Pure Vietnamese automakers. Joint ventures all focus on producing passengers of high price and serve high income people. They only acquire parts meet with their standard. They source local low value-added parts such as batteries tires, seats, electric wire, antenna... from foreign invested autopart companies (some of them are belong directly to automakers) and in general one autopart companies can only supply to two or three companies that they were satisfied standards. There are no joint venture sourcing auto parts and components from pure Vietnamese companies. Although some JVs tried to use parts of local autopart companies, they are not satisfied JVs' standard. For the pure Vietnamese automobile companies, their targeted market is low price vehicles with buses, small and mid-sized trucks and professional vehicles, they have lower requirement of quality but cost, so can accept more locally produced parts and components. However, in spite of obvious quality satisfaction of products of foreign invested autopart, there are a few out of them being sourced by pure Vietnamese automakers because their prices remain high. They are mainly self-localized by self production of parts which source more from other pure Vietnamese autopart companies.

Vietnamese Ministry of Industry announced that there are more than 50 projects of automotive production which are waiting for approve but many of them are for assembly rather than parts production.

[10] Interview with Mr. Pham Van Quy-an expert of the automobile industry

3. Quality

Quality of autoparts are considered as one of reasons hindering promotion of local content rate by joint ventures while pure Vietnamese companies do not believe that have much effect on localization. As above analysis, Vietnamese autoparts industry depends on two sources, one is the foreign invested autopart companies and the other is pure Vietnamese autopart companies. The pure Vietnamese parts producers can not meet with the technology requirement from automobile companies; some products are accepted by the end users but have not yet achieved technology standards of the joint ventures. But it can be said that automakers tried to source locally more, Toyota and Honda found more parts from foreign invested companies while actively established their own factories producing parts and state-own automakers achieved high local content rate and even private company such as Vinaxuki or Truong Hai gained higher local content rate and very eager for the plan of localization.

It is clear that automakers only select parts that satisfy their own requirement of quality and they are willing to localize more if profitable and suitable. That forces automakers to increase their local content rate regardless of quality does not make sense, on the one hand, it go against market rule, putting automakers into an out-of-their ability situation, as a result they are reluctant to do it and even state impossible to do it, on the other hand it harms development of the automobile industry in the future when automakers desire to expand their market and go against consumers' benefits too.

4. Production Cost

Production cost is an important factor in business decision, having direct effect on price variation of outputs, as a result having effect on demand. It can not separate production cost from other purposes. Manufacturers always think of profit, market and cost, trying to reduce production cost in order to increase demand, expanding market, then making profits. Localization must be placed in total production plan and localization must be done for the purpose of lowering of production cost rather than simply meet with national goals. So it is essential to balance between localization goal and production cost.

At present, Car prices in Vietnam are 1.5 to 2 times higher than in Thailand and 2.7 times higher than in Japan. Even imported cars which are subject to 300 per cent tax are the same price as domestically produced cars, so becoming a competitive rival in domestic market that is limited for locally-produced cars by the government. Under capacity

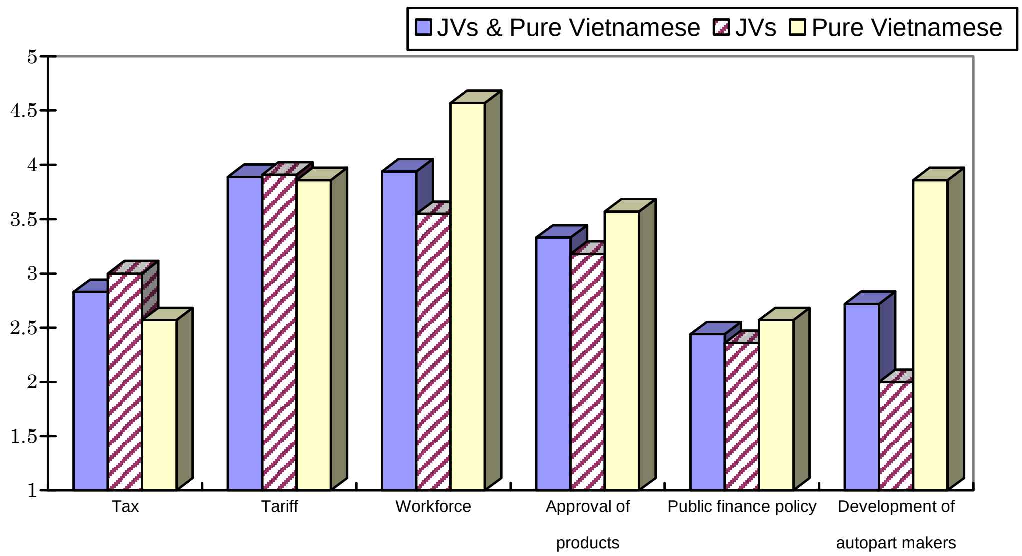
Parts occupy the largest share (normally 70-80%) of the production cost (Ishikawa 2004, pp 4), so parts and components supply directly influence on the price of final products. Up to now, the Vietnamese automobile industry must import a more than 90 percent of the items needed for assembling a car, so prices of imported parts and components depend much on the price of imports. The assemblers asserted that the high cost of parts import contributes considerably into the production cost. Local procurement of parts and components decreases the cost of import such as shipping and packaging; moreover it is quicker and more flexible. Thus, foreign firms are not reluctant to buy local inputs that offer competitive price and quality.

Only by reducing production cost, locally produced cars are possible to compete with imported products and products in the oversea market. The developing countries can make use of cheap labor, cheap land and other production costs to manufacture lower price of products which even compete with the ones from traditional automobile manufacture countries where salary, land… are not their comparative advantages. Thailand now are selected by the world's automobile companies as production and export base and they have moved their autopart companies to Thailand in an effort of cost reduction. Despite the government's pressure, joint ventures asserted that they can not increase local content rate and that price of cars will be even much higher if they are forced to produce parts locally by themselves

VII. EFFECT OF INDUSTRIAL POLICIES ON LOCALIZATION

Chart 3 shows results from rating ideas of automakers in Vietnam on reasons resulting in slow progress of localization.

Chart 3. Effect of government policies on localization of auto products



Source: Research result

Out of suggested causes of localization stagnation, *policy* was rated as the most important reasons. Many interviewees answered the question of localization perspective said that how to improve local content rate and how to develop the automobile industry completely depends on the government policy. It appears that present policy is not clear, not transparent enough for the enterprises to comprehend the targets of the policy makers. Survey results told that majority of the enterprises, particularly joint ventures agreed with the statements saying that "The government is not aggressive in creating favorable condition for localization" and "Policies is not suitable with requirement and expectation of localization", over 50% ideas said that the policy is not transparent and consistent". Enterprises need to grasp unchanged, stable and long-run strategy of the government to make their own strategy, especially in a high-tech and labor-intensive industry that need dozens of years to develop as automobile industry.

Chart 3 shows us effect of present policy of the government on localization by rating effect level of each policy of tax, tariff, market and so on. Among which, *workforce* are appreciated with skilled labor.

1. Tax and tariff

Tariff is also considered having large effect on localization with high protection. The domestic market is protected by more priority for the locally produced products, a high import tariff of 300 percent are levied on CBU (complete build up), high special consumption tax is imposed on vehicles import while the local ones only suffer 5 percent, value-added tax also adds more on the price of imported vehicles while parts and components imported for local assembly only suffers a far lower tariff. Although since 2004, the government planned to decrease protection (see table 5), it is still good condition to invest in Vietnam now.

Table 5. Changes in tariff and tax rates in automotive products

Types of car	**Special consumption tax**		**Tax remission rate**				**VAT**		**Import tariff for CKD kits**		
	Before 2004	After 2004	Before 2004	2004	2005	2006	Before 2006	After 2006	Before 2004	2004	2006
Under 5-seat car	100	80	95	70	50	30	0	8-10	20	25	36
6-to-15-seat car	60	50	95	70	50	30	0	8-10	20	25	36
15-to-24-seatcar	30	25	95	70	50	30	0	8-10	20	25	36

Source: Thời báo kinh tế Việt Nam - Vietnam economic Times, 2004

Although *tax policy* is considered as very important factor to manage the auto industry at this time and future time when WTO commitment of tax and tariff is in effect in Vietnam, it is scored low and criticized not to support to the enterprises. Automobile companies are exempted from income tax for the period of 4 years, exempted from import tariff of equipments, machines, material for fixed assets that have not been domestically produced, exempted from value-added tax, get 50% decrease in income tax for 8 years since making profits, get preferential income tax of 15% to 20% depending on their location (income tax is normally 25%). At present, automakers call for lowering special consumption tax to protect local companies.

In some recent years, policy trend is toward lightening protection, open more market to stimulate competition as well as and go suitable with many free trade agreement, so incentive in tax and tariff is decreased too. However, responses to decrease in protection is different, while JVs all have negative attitude, claiming that increase in tax and tariff makes harm the automobile industry, forces automakers increase car price, so limits market and disadvantages consumers, some pure Vietnamese automakers who have achieved high local content rate asserted that it is their localization that help them to not depend on vibration of price of materials and auto parts. Many pure Vietnamese automakers said that even there is increase in tariff to many parts, they must not increase price of their products, and increase market share. Vinaxuki automaker said that even there are some increase in price of materials and parts recently, but owing to its aggressiveness in localization, Vinaxuki keep its products' price unchanged. However, for JVs, each time when having changes in tax and tariff, automakers all have increased in price of car instead of having improved their own production to lower production cost. Joint ventures asserted that they can not increase local content rate and that price of cars will be even much higher if they are forced to produce parts locally by themselves. In fact, since the early of 2005, pleading on increase in special consumption tax for five-seat cars from 24 percent to 40%, automobile companies all adjusted price. Mercedes C240 rises from USD 69,000 to USD 81,000; Toyota Vios increases to USD 27,000 from USD 24,800. The price of cars increases one and a half times in comparison with that of 2003 after value-added tax and special consumption tax are applied.This phenomena made shrink their domestic market, and figure 2 shows reduction in JVs' sale volume since 2004 too.

Moreover, tariff policy allows imported cars, particularly used cars more chances to be in Vietnam and compete with locally-produced cars. A large number of used cars were imported to supplement to the domestic market that is dominated by high price of locally-assembled cars. Number of car import is up to 16,831 units in 2005, accounted for nearly a quarter of local production volume. This number in 2006 is 12,619 accounted for over one-fifth of local production volume.

Effect of increasing pressure by tax and tariff during recent years results push price of cars up and make consumers puzzled. So market tended to shrink because consumers have hesitated in deciding to buy car with the hope of reduction in car price owing to government's policy adjustment. Each time when government released information of tax and tariff adjustment makes domestic market slump, for example, time in 2004 when decrease in CBU import tariff, consumers suspended buying locally-produced car and waiting for cheap imported cars from China, especially used-imported cars but finally there was no reduction in car price and long-time-being-expected imported Chinese cars remain high price. Moreover, unclear information of changes in tariff of imported CBU under pressure of CEPT (Common effective preferential tariff) among ASEAN countries and WTO triggered irresolution among consumers, and they delayed the time or quit buying cars. Therefore, it contributes to the market shrink.

Present tax and tariff policy does not encourage autopart companies invested in Vietnam. At present, there are no special incentives of tax and tariff for autopart companies. So many of them said they want to invest and ready to invest, however they need to have more incentive from government. Up to now, the government also has some adjustment in tariff in order to stimulate local production of parts and components, however, its effects remain limited. The government decided not to impose tariffs on CKD set as before 2005, instead of it, tariffs on separated parts will be applied and high import tariff on parts, which are able to sourced locally are imposed in order to encourage using local parts. The new local content rate calculation issued by the Ministry of Science and Technology improved method of point calculation list in which all parts and components are divided into one hundred groups of parts and each group is assigned a certain local content rate. On March 2005, Ministry of Finance submitted to the Prime Minister new tariff program on auto parts, in which the parts and components that are being produced locally or need to be encouraged locally will be imposed the reasonable protection tariffs of not higher than 30 percent. The most-protected parts will be bodywork, interiors, tires, tubes, batteries…which are advantages of Vietnam now. But there is no much progress in encouragement of investment in part production, there is still no more investment in part production.

2. Autopart industry development

As valuation showed in chart 3 *development of autopart maker policy* have no much effect on localization. Up to now, there is a limited number of autopart makers including 30 pure Vietnamese autopart companies which are most state-owned auto enterprises and around 40 foreign invested autopart companies which usually registered to produce a bundle of products for both motorbike and car. Many of pure Vietnamese autopart companies were established before 1990s under the management of the former Ministry Engineering and Metallurgy (which is now Ministry of Industry) and Ministry of Transportation. Their main task at that time is to repair and supply certain components and spare parts for imported auto, they also repair, transform auto[11] or produce products for other industries. And although there are many automakers want to invest in Vietnam, autopart makers are not eager to invest in.

Many autopart makers said that in order to invest in Vietnamese market, they need to have a minimum order from automakers, otherwise it is quite risky to start business here. Present policy has not referred to the matter of buying guarantee to automakers. Some partmakers come owing to direct contract with JVs, or JVs directly build up partmakers supporting to them, it is the cases of Honda and Toyota who are also leading localization in Vietnam. Pure Vietnamese companies now also independently develop their own parts to localize more rather than only depend on available partmakers. Vinaxuki must self develop chassis production, forging and molding workshop, engine bloc, engine assembly besides of car assembling, stamping, carriage box, body frame…, so it can achieve 60% of local content rate. Foreign invested autopart makers supply partly to some automakers in Vietnam, and export the remaining to other countries. And they asserted that if only supplying to domestic market, they can not survive because of high cost production due to inability of taking advantages from scale merit. While pure Vietnamese autopart companies usually produced various kinds of industrial products including auto parts rather than specialized in auto products or automakers themselves established their own parts factories supporting to their cars (in this case, usually the automakers are able to manufacture various kinds of industrial products). It is clear that autopart makers in Vietnam must try to find market for their products and domestic market is not enough for them to develop or they must diversify their products rather than focus on only auto parts.

As discussed above, pure Vietnamese autopart companies mainly supply parts to pure Vietnamese automakers and can not satisfy quality standard of JVs, while foreign-invested autopart makers mainly provide products to JVs, however even parts are accepted by some JVs, they may not be accepted by the others. Pure Vietnamese automakers can not accept product of foreign invested automakers because of high price. Therefore, the differentiation narrows down market for autoparts makers.

Moreover, supporting services for the auto part production has not yet been developed. The final products in the automobile industry require various kinds of supporting industries and the later are quite important for the development of the former. Supporting industries cover a very wide range of parts and components used in assembly of final products through the supply of parts and components or immediate goods. Vietnam like other ASEAN countries is originally agricultural countries and although Vietnamese mechanical industry has been developed for 50 years but achieved moderate success. Materials for locally produced parts and components such as steel ingot and steel plates... must import because domestic companies have not yet been able to produce. So it make higher production cost due to delivery cost. In additionally, small volume of sale contributes to higher production cost because companies can not make use of their investment of equipment, factory, staff and so on.

3. Others

Land is not difficult question to automobile companies owing to various industrial zone located in favorable sites around major cities. Even joint-ventures marked higher score in comparison with pure Vietnamese companies, they all said land for factory sites, buildings

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[11] Auto transformation refers to building a new bus from the chassis of the a truck. In Vietnam, during 80s and 90s, auto mechanical factories are used to build 45 seat buses on the chassis of East Germany IFA W50L medium trucks. This activity is banned from Sep 2000.

not difficult matter to deal with. Also is *capital mobilization, cash grant and finance policy*, there are still many investors look at chances in Vietnamese auto industry, so capital mobilization not really influence on investors' decisions. In fact, either pure Vietnamese companies or joint-ventures got any cash subsidies from government. For the *research and development policy*, although the government plan to give financial support for research and development activities, in fact, no projects is approved and financed, also enterprises do not care it much.

VIII. PRELIMINARY CONCLUSIONS

Vietnamese automobile industry has started since 1991, however, locally produced cars are mainly based on imported parts and components and localization rate is contributed mainly from assembling, wielding and painting, there are a few parts sourced locally. Stagnation seems to appear in localization progress when automakers hesitate sourcing more local parts.

The automobile industry clearly needs an encouragement to overcome the current situation. Among many factors, market, autopart makers, production cost and quality are the most important ones to discuss before deciding localization. Localization must be implemented on the purposes of accepted quality and cost reduction. It is impossible to sell a bad quality of products that have short durability, pollute environment and have bad effect on image of companies. It is impossible to increase local content rate regardless of cost production because it go against consumer's interest and it is not economically efficient and automakers themselves can not sell car with over-price. So it is obviously market will be essential factor to consider when localization because it will catalyze to develop local content. And obviously, development of autopart industry will decide localization in the auto industry, the matter is how to attract them to aggressively invest in.

Amid the current situation, industrial policies are useful and helpful to facilitate the auto industry via improvement of localization factors. However, current policy has not a positive effect on localization. The government only gave out inflexible requirement to automakers without mutual consultant between business side and policy makers of reasonable industrial policies. So, it raises a protest from business side of an unsuitable requirement of government regardless of production cost and products quality. Additionally, the industrial policies do not encourage market as well as autopart makers, resulting a vicious circle in the automobile industry.

Vietnam began to develop its automobile industry in the 1990s, some 30 years later than other ASEAN countries. Despite this, it faces the same competitive conditions in terms of tariffs, and sooner or later the tough changes happening among ASEAN market. This means that Vietnam are challenging to difficult task of building a competitive automobile industry in the brief time remaining before liberalization. However, there exists chance for Vietnamese automobile industry to grow and improve localization of auto products if it can utilize its advantages under the assistance of government in order to overcome the current stagnation and future challenges in regional market, as well as, international market.

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