
Vietnam Development Forum

# INDUSTRIAL POLICY FORMULATION IN THAILAND MALAYSIA AND JAPAN

*Lessons for Vietnamese Policy Makers*

EDITOR: **KENICHI OHNO**

The Publishing House of Social Labour

# Industrial Policy Formulation in Thailand, Malaysia and Japan

## Lessons for Vietnamese Policy Makers

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# Contents

# Preface

The Vietnam Development Forum (VDF) is a policy research project between the National Graduate Institute for Policy Studies (GRIPS) in Tokyo and the National Economics University (NEU) in Hanoi. It is funded by the Japanese government.

Since its establishment in early 2004, VDF has cooperated very closely with the Ministry of Industry (MOI) of Vietnam. The central theme of our cooperation is exploring the way to improve the methodology of industrial policy formulation.

In Vietnam, a significant gap has emerged between the old policy method based on quantitative planning and the designation of public investment projects on the one hand, and the rapidly changing reality under market-orientation and global integration on the other. Many MOI officials are well aware of this gap, and seek concrete and practical intellectual inputs to revise their policy method.

To support this effort, VDF and MOI have organized three joint missions to Thailand, Japan and Malaysia from early 2005 to early 2006. In each country, we collected key industrial policy documents, and asked how policies were designed, implemented, and reviewed. We also learned how the government and the business community talked to each other, what organizational structure was adopted to draft policy documents, and how inter-ministerial coordination was ensured.

By publishing this report, we would like to share our findings with a broader community of policy makers and researchers in Vietnam. While political situations and policy methods may shift over time in each surveyed country, we believe that information gathered by our missions, when regarded as clues to improve policy formulation, has value largely invariant to such changes.

VDF takes full responsibility for the content of this report. No assertion in this volume should be construed as the official views of either MOI or the organizations and people whom we interviewed. The titles of the officials and other participants of our research are those at the time of the interview.

Tokyo, May 2006

Kenichi Ohno
Co-leader, VDF

# Mission Dates and Members

## Mission to Thailand

Location: Bangkok and vicinity
Period: February 28 to March 4, 2005

Members: *Ministry of Industry:*
Mr. Le Van Duoc (Director, Department of Planning)
Mr. Hoang Trong Hieu (Expert, Department of Planning)
Ms. Nguyen Thi Doan Hanh (Expert, Department of International Relations)
Mr. Hoang Bac (Expert, Department of Mechanics, Chemicals and Metallurgy)

*Vietnam Development Forum:*
Prof. Kenichi Ohno (Project co-leader)
Mr. Mai The Cuong (Researcher)
Mr. Ngo Duc Anh (Researcher)
Mr. Pham Truong Hoang (Researcher)
Ms. Duong Kim Hong (Researcher)
Mr. Vu Huy Thong (Lecturer, National Economics University)

## Mission to Malaysia

Location: Kuala Lumpur and vicinity, and Penang
Period: January 9 to 13, 2006

Members: *Ministry of Industry:*
Dr. Cao Xuan Thanh (Deputy Director, Department of lanning)
Mr. Trinh Dinh Thang (Senior Expert, Department of International Cooperation)
Mr. Hoang Trong Hieu (Expert, Department of Planning)

*Vietnam Development Forum:*
Prof. Kenichi Ohno (Project co-leader)
Mr. Mai The Cuong (Researcher)
Mr. Ngo Duc Anh (Researcher)
Mr. Nguyen Ngoc Son (Researcher)

**Mission to Japan**

Location: Tokyo
Period: May 30 to June 3, 2005

Members: *Ministry of Industry:*
Mr. Le Van Duoc (Director, Department of Planning)
Mr. Cao Xuan Thanh (Deputy Director, Department of Planning)

*Joining from Japan:*
Prof. Kenichi Ohno (VDF co-leader/GRIPS)
Ms. Nguyen Thi Xuan Thuy (GRIPS/MOI)
Mr. Pham Truong Hoang (Yokohama National University)
Mr. Junichi Mori (Fletcher School, Tufts University)

# Chapter 1 Integral Manufacturing: The Way Forward for Vietnam

Kenichi Ohno
Vietnam Development Forum and
National Graduate Institute for Policy Studies

Our research missions to Thailand, Malaysia and Japan in 2005 and 2006 studied the different policy formulation methods of these countries, including both their strengths and weaknesses, to draw concrete lessons for Vietnam. In this chapter, the framework of thinking within which this research was Conducted, as well as my conclusion after the missions, are presented.

## 1. The need for new industrial policy

Vietnam is deeply committed to global and regional integration, and no one doubts the seriousness of this commitment. Vietnam has already taken many steps to realize this goal, including the completion of the AFTA process, the conclusion of the bilateral trade agreement with the United States, intense negotiation for WTO accession, and preparation for other free trade areas (FTAs). Work is also progressing in the legal area, as the government doubles its effort to create or amend a large number of laws for consistency with international practices. All this is highly commendable.

However, diplomatic and legal preparations are not enough. In order for Vietnam to truly enjoy the fruits of international integration, its real sector must also be prepared. Vietnamese firms need to be competitive enough to survive and even prosper in the new open environment where import protection and special favors are, in principle, no longer allowed. And this is the area in which Vietnam's preparation is the weakest.

In a market economy, the natural selection of enterprises is not only acceptable but also desirable. Ill-managed firms go bankrupt while new

firms emerge incessantly, giving dynamism to the national economy. In this sense, we do not expect all existing domestic enterprises to survive the integration shock. However, globalization also carries the risk of de-industrialization and getting stuck with primary commodity production and simple assembly. If a large chunk of Vietnamese industries is wiped out and the domestic market is dominated by imports and FDI firms, and if this trend continues year after year without any sign of reversal, is it acceptable to the Vietnamese people?

Of course, this may not happen. Vietnamese producers may prove to be stronger than we think. But should outcome be left to chance? At present, Vietnam cannot assess or cope with the integration risk properly since there is no clear vision, analysis, target setting or promotion policy. In Thailand and Malaysia, the government and the business community create joint strategies to meet the challenge of international competition. But in Vietnam, no such strategy exists. This gap must be filled by industrial master plans.

Free-market advocates may argue that, once the economy is open and free, the market mechanism will activate the ingenuity of the Vietnamese people and the national economy will grow and become more efficient. This argument is too naive, and the majority of Vietnamese policy makers already know it. The fact is that the balance of power between large advanced economies and latecomer developing countries is lopsided. Vietnamese firms cannot at present compete squarely with Toyota, Panasonic, LG or Intel in the global market. Instead, they must work with these multinational corporations (MNCs) to improve their abilities and become crucial suppliers in their global value chain. A good policy is needed to encourage and support this effort.

But what kind of policy, more concretely? The days of planning are over. Vietnam can no longer use rigid control to maintain international isolation. The strategy of *infant industry promotion*, adopted by Japan and Korea in the early postwar period, is also out of question. Under this strategy, domestic industries were protected and nurtured until they became sufficiently competitive. But Vietnam cannot introduce such protection because of its commitments to WTO and various FTAs.

Even the strategy of FDI-led growth, exercised by ASEAN4 in the 1970s-90s, is no longer applicable to latecomers like Vietnam. Although Malaysia, Thailand, Indonesia and the Philippines vigorously absorbed FDI, they were slow to remove their tariffs, import restrictions and localization requirements. In these countries, FDI promotion and industrial protection coexisted for at least a few decades. External barriers were lifted only after they achieved significant industrial agglomeration. But Vietnam is asked to remove barriers *now*, before such agglomeration occurs.

For this reason, Vietnam's industrial policy in the 21st century must be new and different from those of other countries in the past. It must reflect the fact that even newcomers must open up very fast. Globalization is inevitable, and Vietnam must position itself to become a meaningful player in the global arena, making sure that its contribution to East Asia and the world will rise over time. What kind of policy can that be? That is the key question for the Ministry of Industry (MOI) in particular and the Vietnamese government in general to consider. That is also the question we wanted to address when we traveled to Malaysia, Thailand and Japan.

## 2. Weaknesses in Vietnam's policy formulation

To design and implement industrial policy in the age of strong globalization pressure, Vietnam must overcome two methodological problems. At present, master plans are designed and drafted by a small group of officials assigned for the task. They work very hard but cannot produce desired results, because crucial information and cooperation are lacking. More concretely, the weaknesses of Vietnam's industrial policy mostly stem from the following two missing links.

(i) The lack of cooperation with *stakeholders* (i.e., concerned groups) in the entire drafting and implementation process. In the case of industrial master plans, the most important stakeholder is the business community.

(ii) The lack of inter-ministerial coordination within the government in deciding concrete action plans.

These problems are unique to Vietnam as they are not observed in other high-performing East Asian countries. In our missions to Thailand, Malaysia and Japan, no serious problems were reported in either government-business cooperation or inter-ministerial coordination in formulating industrial policy.

The main problem caused by the lack of cooperation with stakeholders is that *policy is not supported by the business community and therefore not implementable*. This problem is particularly acute in sectors where private and FDI firms-which are not under MOI's direct supervision-dominate, such as motorbikes, automobiles, and electronics. Even in areas where state-owned enterprises (SOEs) used to play key roles, such as steel and cement, the share of private and FDI production is rising. The drafting process must involve all key players, especially private and FDI firms. Without solid channels to absorb their information and concerns, policy remains ineffective.

Another problem caused by the lack of stakeholder involvement is that *information and analysis are neither to-the-point nor up-to-date*. Even if MOI drafters are intelligent and hard working, it is difficult for a small team to gather all relevant information. This is particularly true with external information such as global industrial trends or the latest strategies of MNCs. Such information should be obtained through close and continuous contact with the business community. A good policy cannot be built on outdated information.

On the other hand, the main result of the lack of inter-ministerial coordination is that *supporting measures are simply mentioned without details*. Measures outside the authority of MOI, such as tariffs and tax incentives or a reform of technical schools and universities, are especially hard to prescribe in detail, since there is no mechanism to discuss and agree on policy measures among related ministries in close consultation. At present, ministries interact only superficially through commenting on mutual drafts and exchanging basic information. This is another reason why timely and effective policy implementation is so difficult in Vietnam.

## 3. Good policy, modest results

All three countries featured in this report-Thailand, Malaysia and Japan-have constructed effective channels for stakeholder involvement and inter-ministerial coordination in industrial policy making. Thailand has set up industry-specific institutes and official committees to link the government, businesses, and experts. Malaysia has a three-layer structure consisting of the Industrial Planning Committee, the Steering Committee, and technical resource groups, which together mobilize several hundred people to draft an industrial master plan. In Japan, deliberation councils and industry associations have long been the key instruments for sharing information among all stakeholders at any time. The functions of these institutions are explained in detail in the following chapters.

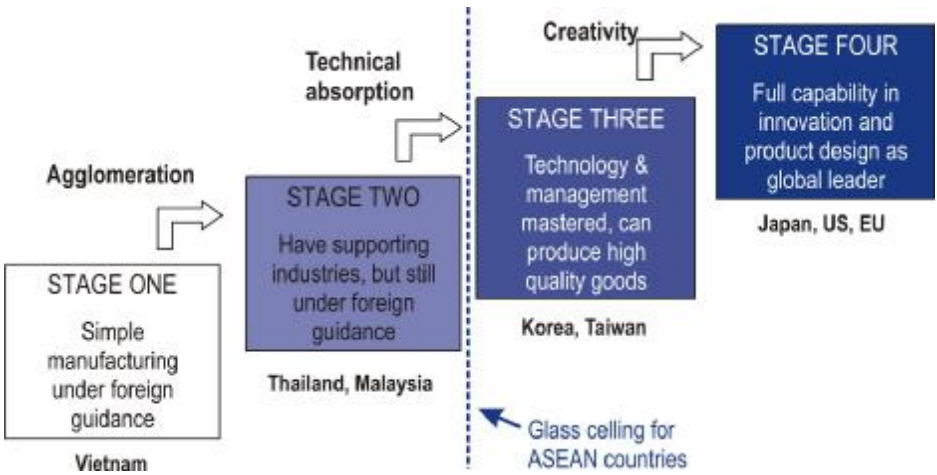
The experiences of these countries make it clear that Vietnam is far behind them in industrial policy formulation and that it has much to learn from them. It must be admitted that Vietnam's policy making method is in the early stage of development. It is still primitive and defective, and inherits many characteristics of the planning days which are no longer valid. Another crucial fact is that the way to achieve good involvement and coordination is not one, and that Vietnam should design a mechanism which is most suitable for its situation and needs. This means that Vietnam must selectively import the good practices of neighboring countries, with necessary revisions and additions, to suit its circumstances. Since institutional evolution is difficult to forecast or plan with any precision, the adaptive process will inevitably be a long one with many trials and errors.

However, there is also a negative lesson from Thailand and Malaysia that is worth attention. While industry-led growth of Thailand and Malaysia has been remarkable by the standards of developing countries in general, it falls short of East Asia's high performance criteria. These two countries are still unable to break through the "glass ceiling" after several decades of industrialization. The glass ceiling here refers to the difficulty in moving from the second to the third stage in the path of

industrialization that I have described on another occasion[1].

A developing country in the catch-up process typically starts with simple assembly to fulfill foreign orders (stage 1), builds industrial agglomeration and supporting industries (stage 2), graduates from foreign guidance to master technology and management (stage 3), and finally achieves innovative, original design capacity (stage 4). I argue that none of the ASEAN countries has graduated from foreign dependency despite their quantitative achievement. They still rely heavily on foreign managers and engineers to run their factories and maintain quality. Since core competence and value creation are not internalized, there is always a risk that industries will shift to China or elsewhere when situations change.

**Figure 1-1. Breaking the Glass Ceiling**




Source: see footnote 1

[1] Kenichi Ohno, "Designing a Comprchensive and Realistic Industrial Strategy", chap.1, Kenichi Ohno and Nguyen Van Thuong, eds, *Improving Industrial Policy Formulation*, Publishing House of Political Theory, 2005 (pp.24-26).

The governments of Thailand and Malaysia are acutely aware of this problem and trying to remedy the situation as a matter of top national priority, as the following chapters indicate. Specifically, this requires strengthening SMEs and creating linkages among them, developing industrial skills, promoting supporting industries, stimulating R&D, and other efforts in human resource development. Nevertheless, local capability of Thailand and Malaysia still falls short of the high requirements of Japanese manufacturing FDI. This is a problem that has been recognized for a long time-at least for two decades-but remains unresolved.

At the risk of over-simplification, we may even say that Thailand and Malaysia are the countries whose governments have succeeded in offering good policy frameworks but whose domestic businesses remain less dynamic than expected. The gap between good policy and modest results is especially striking when we look at the performance of Taiwan and Korea. From the situation of war devastation and dire poverty, they emerged as leading manufacturers of high-quality products in a few decades. They received foreign technical assistance at first, but the time they spent for learning was relatively short. As soon as they mastered technology, they sent foreign advisors home. R&D, product design, enterprise management, and factory operation are now carried out entirely by locals. They invest vigorously abroad to expand production networks, and have become Japan's formidable competitors. And all this was achieved in no more than the time it took for Thailand and Malaysia to reach their current levels.

Why did Taiwan and Korea move up so fast, while Thailand and Malaysia learned more slowly? The reason may be the difference in national character or the difference in policy quality. If Taiwanese and Korean people are genetically more suitable for high-quality manufacturing than Thai and Malaysian people, there is not much the government can do to change people's DNA. But if industrial policies adopted by Taiwan and Korea have been superior in matching national aspiration with needed actions, we are compelled to study much deeper into policy design and implementation to improve the

industrial policy framework and content of Vietnam[2].

Vietnam at present is a country of weak policy formulation. However, Vietnamese people are frequently praised as skillful, diligent and persistent in comparison with other peoples in the region. This points to a possibility of greatly upgrading the industrial capability of Vietnam once policy weaknesses are removed.

## 4. Coping with China

How to cope with China, with its enormous size and rapidly expanding manufacturing capacity, has become one of the most urgent issues all over the world. China has large numbers of managers, scientists, engineers and unskilled workers, ample industrial materials, a relatively high level of technology backed by a long history of industrialization drive, and a thick network of overseas Chinese businesses. The China challenge looms large in the industrial policy debates of Thailand, Malaysia and Japan. It must also be a top issue in formulating Vietnam's new industrial policy.

It is clearly unwise to directly compete with Chinese products in the global market. To avoid this, a country must differentiate its products from Chinese, and position itself as a producer complementary to China rather than competing with it. If this is done successfully, the country can form a production partnership with China and use Chinese low-cost inputs to its advantage. The crucial question is how to do this concretely. The proper positioning requires a clear understanding of the fields in which China excels and the fields in which it does not.

Since China is a big country, it is not easy to find industrial categories that are not produced by it. One needs to go into the level of individual products and even different grades of the same products, to find a niche. Even then, there is no guarantee that China will not produce that

[2] Two facts complicate such a study. First, the policies adopted by Taiwan and Korea were very different in that the former promoted dynamism of SMEs while the latter featured large business groups (chaebols) supported by large banks. Second, state-led industrialization strategy adopted by Korea, in particular, is no longer available to latecomer countries of today under the globalization pressure.

product next year. Many countries want to promote "high-tech" industries to upgrade its skills and compete with China. However, the popularity of this strategy must be evaluated against the following precautions: (i) there is a significant gap between national aspiration and actual capability; (ii) no differentiation will occur if all countries adopt this strategy; and (iii) China is also targeting such areas.

Thus, finding a niche in terms of specific products, including "high-tech" products, has certain limits. The better way to distinguish oneself is to analyze China's strengths and weaknesses from the viewpoint of business architecture, as explained below.

## 5. Integral manufacturing

We would like to propose one concrete industrial strategy for Vietnam in order to overcome the difficulties addressed in earlier sections. The strategy is targeted at building domestic capability in assembly-type manufacturing, such as electronics and electricals, motorbikes, and automobiles, and the production of parts and components of these industries[3]. Although assembly-type manufacturing industries differ from one another in some aspects, they are common in the sense that (i) they extensively use metal, plastic and rubber parts; (ii) product quality heavily depends on the quality of these parts; (iii) they also require labor-intensive assembly with precision; and (iv) innovation and model changes are quick and frequent. For this reason, assembly-type manufacturing industries can to a large extent share the same supporting industries and human resources. That is why they should be grouped together in strategic planning.

Vietnam's workforce is particularly suited to labor-intensive assembly with precision mentioned above, and that is why such FDI inflows are accelerating in recent years. However, Vietnam must also learn and internalize the other aspects, (i) (ii) and (iv) above, to fully take

[3] Assembly-type manufacturing has been the driving force of economic transformation of Japan, Taiwan, Korea, ASEAN4 and China, and it is also expected to play the same role in Vietnam. For other industries, such as garment, footwear, food processing, software, energy, industrial materials, construction, logistics, trade, telecom, finance, tourism, etc, other strategies must be sought since the argument in this section is not applicable to them.

advantage of the strength of assembly-type manufacturing. If this is done successfully, assembly-type manufacturing will surely become the main pillar of Vietnam's industrialization, providing jobs, improving skills, and raising national income.

Even without any further policy reform, FDI will probably continue to come to Vietnam and, given sufficient time, the country will reach the income and industrial levels of Thailand and Malaysia today. However, as argued above, these ASEAN neighbors remain heavily dependent on foreign technology and management. Despite many decades of supporting industry and SME promotion, their human resources and local parts makers remain too weak to break through the "glass ceiling" and reach the level of Taiwan or Korea. If Vietnam does not have a good policy, it is also likely to stop at the level of Thailand and Malaysia today.

Another important consideration noted earlier is that Vietnam is required to integrate much faster than ASEAN4. Thailand and Malaysia absorbed a large amount of FDI, but they were not "open" in the sense that they kept high tariffs, localization requirement, import restrictions, etc. for a long time. They used these measures for at least a few decades to develop and protect their industrial base. But Vietnam must open up now, before building such an industrial base, and face global competition. Vietnam's industrial strategy must therefore be different from and bolder than those of Thailand and Malaysia.

Let us now propose a new manufacturing strategy for Vietnam based on the above considerations.

(1) Vietnam should liberalize its trade and investment regimes unconditionally and more decisively than ASEAN4 did in the past, create the most free and low-cost business environment in East Asia, and attract a large amount of FDI without selectivity[4]. This decisive openness should be the strongest selling point in FDI marketing.

[4] The only permissible reasons for rejecting FDI are environment, cultural indecency, and national security. This rule should be applied sparingly under transparent criteria.

(2) Linkage between domestic firms and foreign multinationals should be promoted as a matter of highest priority. Vietnamese firms should double efforts to become suppliers of FDI manufacturers and foreign buyers, and improve their capabilities. The government should support their effort.

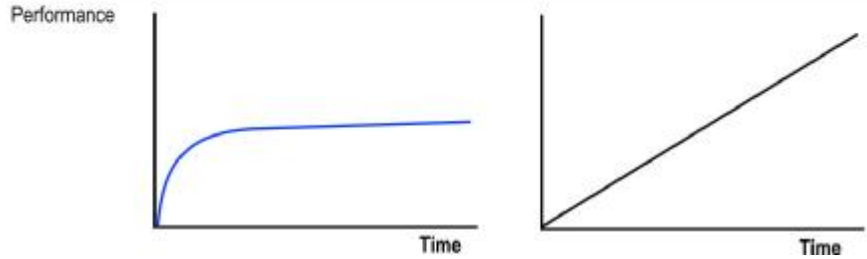
(3) Vietnam should learn the *monozukuri*[5] spirit of Japan's *integral manufacturing*, as explained below, as quickly as possible. Vietnam should aim to become a reliable developing country partner in high-quality manufacturing with Japan and other developed countries producing integral products.

Prof. Takahiro Fujimoto of Tokyo University and his research team have come up with the business architecture theory to explain the differences among the manufacturing industries of major economies such as Japan, China, the United States, Korea, Taiwan, and ASEAN countries. This theory has a significant implication for Vietnam's industrial strategy. According to Prof. Fujimoto, there are two basic architectural types in manufacturing-modular architecture and integral architecture. In modular architecture, the modality of interaction among components is standardized for easy connection. For example, desktop computers are a typical modular product in which globally common components from various companies are freely combined. By contrast, in integral architecture, the complexity of interaction is happily accepted, and improvements are achieved through numerous trials and errors. For example, automobiles must be manufactured with integral architecture if multiple objectives such as performance, comfort, fuel efficiency, safety, etc. are to be attained simultaneously. Generally speaking, modular architecture is suitable for obtaining quick results at low cost while integral architecture is appropriate for the pursuit of ever-higher quality in the long run.

[5] *Monozukuri* literally means "making things" or "manufacturing".

**Figure 1-2. Modular versus Integral Manufacturing**

| | Modular manufacturing | Integral manufacturing |
|---|---|---|
| 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 requirement | Openness, quick decision making, flexible outsourcing | Long-term relations, building internal skills & knowledge |




Correspondence between products and business architecture is not fixed; it evolves dynamically with the business strategy of each firm or country, technical progress, and consumer tastes. In addition, business architecture often has structural layers in which, for example, modularization may proceed in final assembly while integration may deepen in components.

Japan is a country of integral architecture, intensely interested in efficient factory operation and product integrity. By contrast, the United States excels in modularization and is good at slicing the supply chain of a product into appropriate elements, standardizing them and making profits by the novelty of combination. China is also a country of modular architecture, but its comparative advantage lies in labor-intensive modular products rather than knowledge-intensive modular products as in the case of the United States. Prof. Fujimoto considers China to be a country of quasi-modularity since its manufacturing features mass production of products with copied design and technology rather than original innovation.

Since the United States and China are both modular countries with different development levels, they are complementary production partners. The former can supply technology and capital while the latter can offer cheap labor to produce modular products. Meanwhile, Japan is a country of integral manufacturing with high technology, high wages and aged population looking for a developing country partner. Using cheap unskilled labor in China and ASEAN is not enough to fully exploit the potentiality of integral manufacturing. If ASEAN, the traditional destination of Japanese FDI, learns to become a manufacturing partner with long-term vision and strong aspiration for high quality, Japan and ASEAN can form a strategic alliance in manufacturing integral products which are differentiated from Chinese products. However, this alliance remains a possibility since no ASEAN country has acquired necessary skills and attitude for Japanese-style manufacturing. As noted above, Thailand and Malaysia are currently struggling to become full-fledged manufacturing countries. They still need Japanese managers and engineers to stay, and depend heavily on FDI parts producers.

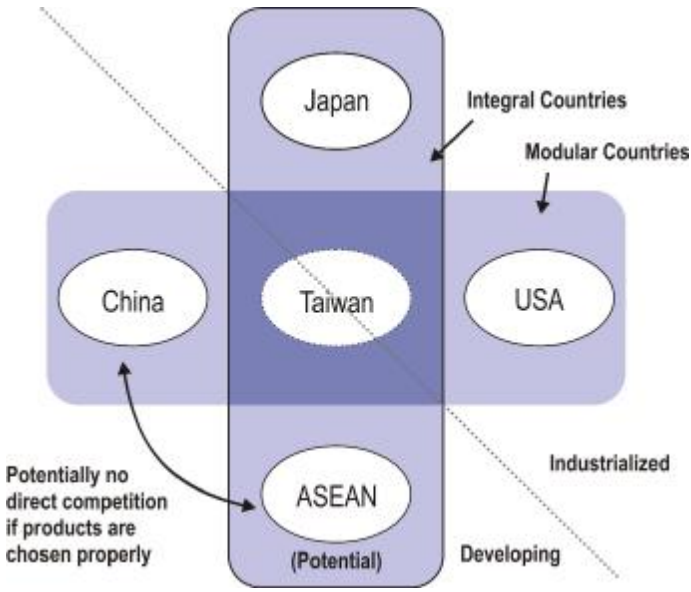
To become a partner in integral manufacturing requires ability to design and operate factories efficiently; maintain, adjust and repair machines; design parts; produce precision molds and dies; educate highly skilled industrial Meisters, and so on. These requirements are not new. But the point is that they must be accomplished well with purpose and tenacity. This will enable ASEAN to graduate from simple assembly by foreign orders to participation as an indispensable player in the global manufacturing network. This will also upgrade the Japan-ASEAN economic relationship to a higher level.

Among ASEAN countries, Vietnam and Thailand are top candidates for this feat. Vietnam should set a clear goal with appropriate action plans, and the Japanese government and business community should actively provide technical assistance and business cooperation for this purpose.

This perspective explains why supporting industries (especially high-quality plastic and metal processing industries) and human resource development (especially high-level production managers and

engineers) are so crucial for Vietnam. They are needed to significantly raise domestic manufacturing capability, and to differentiate Vietnam from China and other ASEAN countries. It also means that copying China's manufacturing style or receiving Chinese technical assistance is not desirable for Vietnam since it only leads to low-price, low-quality competition yielding little profit, as well as a direct clash with Chinese products.

**Figure 1-3. Production Alliances Based on Business Architecture**




Source: Prof. Takahiro Fujimoto's explanation to the joint VDF-MOI mission in Tokyo, June 2005

## 6. Anticipated skill shortages in Japan

Japan desperately needs a developing country partner in integral manufacturing but has found none so far. It needs such a partner since its wages are too high and its population is aging, making it very difficult to find young engineers and production managers in sufficient number and quality inside Japan. The postwar baby boomers, born in 1947-49, with high skills are reaching the retirement age soon. The 1947 babies will become 60 years old in 2007 and begin to leave

factories (the "2007 problem"). Their skills must be transferred to the next generation but Japan lacks a sufficient number of successors.

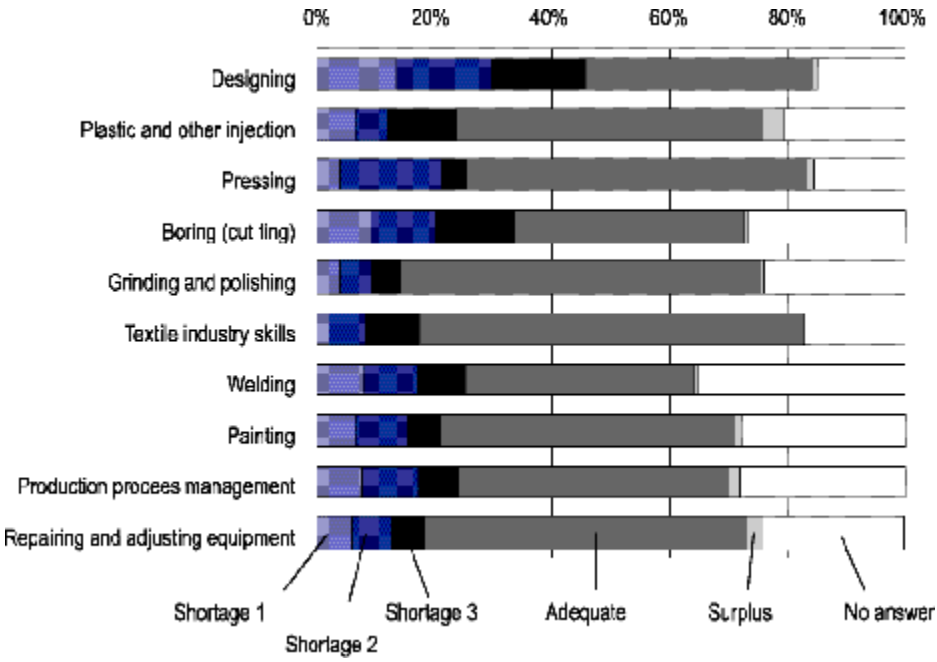
According to the *White Paper on Monozukuri*[6], the number of monozukuri workers in Japanese manufacturing was 1.93 million in 2005. When asked if the "2007 problem" (retirement of skilled workers) was a serious concern, 30.5% of the manufacturing firms responded yes. Among them, main reasons for their concern included long time required for skill transfer (68.5%), lack of younger engineers with enthusiasm (64.5%), and difficulty in communication between teacher and student due to a large age or skill gap (41.9%).

Figure 1-4 shows the worker shortages for the ten largest basic industrial skills in Japan. As of 2005, worker shortages are not yet severe, with only 25.6% of the respondent firms reporting skill shortages in quantity or quality (or both), 47.9% reporting adequacy, and 1.7% reporting surpluses (these numbers are averages for the ten skills). However, as time progresses, skill shortages are likely to worsen. Many firms are expected to retain skilled workers beyond the retirement age, which will delay the impact of the 2007 problem for several years. But in the long run, Japan will inevitably face skill shortages unless fundamental solutions are found.

I have highlighted Japan as a principal monozukuri partner for Vietnam, since Japan is the only country in East Asia that has achieved a high level of integral manufacturing. In addition, Japan is already the most important manufacturing investor in Vietnam. Moreover, if Vietnam masters integral manufacturing, it can also cooperate more effectively with, for example, German automobile producers or Italian machinery companies. That is why I sincerely hope that high aspiration for assembly-type integral manufacturing be incorporated as one of the strategic pillars of Vietnam's overall industrial master plan.

[6] Ministry of Economy, Trade and Industry; Ministry of Health, Labor and Welfare; and Ministry of Education, Culture, Sports, Science and Technology, White Paper on Monozukuri, 2005. Data in the text were obtained from the survey by the Ministry of Health, Labor and Welfare on enterprises with five or more regular employees.

## Figure 1-4. Shortages and Surpluses of Monozukuri Workers in Japan




Source: see footnote 6

Note: These are the survey results on the ten basic industrial skills with largest numbers of workers in 2005. Shortage 1, 2 and 3 are shortage in quantity, shortage in quality, and shortage in both quantity and quality, respectively.

# Chapter 2 Industrial Planning in Vietnam and Lessons from Abroad

Le Van Duoc and Cao Xuan Thanh
Ministry of Industry

Among economic policy instruments, planning is essential in assisting the government to regulate and manage the economy effectively and achieve socio-economic goals for each stages of development. This chapter first reviews historical transformation and problems in industrial planning of Vietnam. In Section 2, experiences from other countries are reviewed. Finally, Section 3 draws lessons for Vietnam from these experiences.

## 1. Changes in industrial planning in Vietnam

Vietnamese industrial planning in principle has followed the general rules required by economic planning. Historically, industrial planning can be divided in to three stages: (i) central planning period from 1955 to 1975, (ii) initial renovation period from 1976 to 1985; and (iii) innovation period from 1986 to present.

### 1.1 Central planning period from 1955 to 1977

In the early period, Vietnam was divided into two regions. The North, after liberation, started to construct socialism while the South continued to fight for unification. In the North, the government applied planning methodology originated in the Soviet Union with the following characteristics:

(i) Resource allocation was prioritized to two main economic sectors, namely the state and collective sectors, to achieve plan objectives.

(ii) Plan objectives were mandatory. There were a large number of commodity targets which were closed and balanced within each sector and within each region. The state budgeted both inputs and outputs in production and enterprise operation.

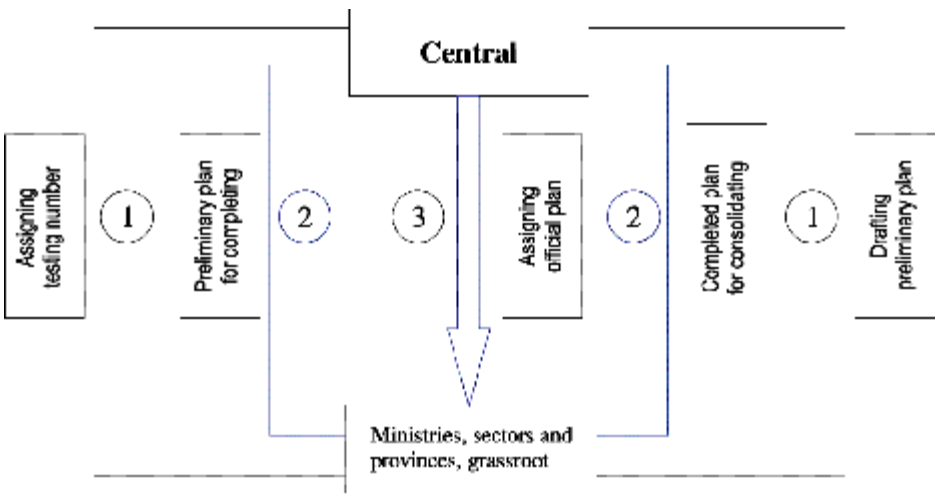
(iii) The state managed and controlled economic activities through central directives. Concrete objectives were determined by planners. Resources such as capital and materials and product distribution among sectors were decided by criteria which rarely changed.

(iv) The plan building process was characterized by hai len ba xuong (two ups and three downs-the sequence of top-down provision of numerical targets, bottom-up checking and drafting, top-down revisions, bottom-up redrafting, and top-down synthesis and final approval; see Figure 2-1).

(v) The highest planning authority was the State Planning Committee whose main function was to synthesize key plan contents from all industries and all local governments while giving a focus on strategic economic areas, essential economic objectives, and important products and projects for the national economy. As the next authorities in charge, ministries and general offices also compiled their plans by giving directives to their lower units. Provinces and cities were responsible for constructing and synthesizing plans for their own areas.

**Figure 2-1. Designing and Approving Process of Planning**

("2 up 3 down" Modality)



The centrally planned mechanism represented state power and legality of economic objectives, and assured fundamental balances of the entire economy as well as principal industrial and agricultural products. Concrete objectives of the government were mainly aimed at reconstructing, improving, and developing the socialist economy in the North while simultaneously supporting the South to fight for the unification of the country.

However, from 1975 as the socio-economic situations changed significantly, planning based on old methodology began to show many constraints and meet many obstacles, which tended to deter economic development. These constraints and obstacles included the following:

(i) The system of rigid commodity targets reduced enterprises' flexibility and creativity. Enterprises reacted perfunctorily, passively and unwillingly, and hence could not play the role of the engine of economic development.

(ii) Plans were subjected to the discretion of leaders and planners.

(iii) Scientific foundation, such as the use of growth projection, master plans and IO tables, was lacking.

(iv) Objective rules were not recognized and applied properly.

To overcome these constraints for the sake of production and economic efficiency, initial changes in planning method were introduced during the post-unification period, particularly at the beginning of 1980s.

## 1.2 Initial renovation period from 1976 to 1985

In this period, Vietnam implemented two five-year plans: the Second Socio-economic Development Five-year Plan (1976-1980) and the Third Socio-economic Development Five-year Plan (1981-1986).

In the period 1976-1980, planning was still highly administrative, direct and material. For instance, Parliament Decision dated December 28, 1977 approved the basic tasks of the five-year state plan from 1976 to 1980 with numerical targets such as 21 millions tons of cereals, 1.8 million laborers to open new economic regions, 3,500 million eggs,

16.5 millions pigs, 1 million tons of meat, 1 million tons of sea fish, 14 million square meters of housing (excluding houses built by people), 450 million meters of cloth, etc. Needed resources were mainly supplied from abroad.

In the period 1981-1985, renovation was initiated with Decision No.25-CP and No.26-CP dated January 13, 1981, which introduced "three-part industrial planning." The planning mechanism changed from direct to indirect. A system of mandatory targets was reduced and gradually replaced by an indicative system of informative guidance. Enterprises were given self-control based on market demand and economic contracts. Some targets were retained for key products. Profit and financial policies were changed to encourage enterprises to proactively develop self-balance plans. The chairman of the Inter-ministerial Committee issued Instruction No.3-CT on January 11, 1982, which required a change in the design of the five-year plan 1981-1985 with respect to the content and modality of planning. According to the Instruction, plans were designed at three levels, namely central, provincial and lower units. Designing and collecting plans were to start from lower units. This encouraged the spontaneity of the lower level while securing the consistent central management of the state. At the central level, the State Planning Committee remained the national planning authority, which ensured the macro balance of the economy. Provinces and cities designed and collected plans from their lower units and districts. They were to implement the state's legal targets while promoting capital accumulation for provinces. Lower units (enterprises, cooperatives, farms, etc) were required to be proactive and creative in their business and production based on the principle of self-finance while executing state's policies, regulations, and targets.

Planning methodology changed dramatically in this period. Importance was now placed on basic surveys, socio-economic forecasts, master plans, technical and economic norms, and selection of most effective projects. Productivity, quality, efficiency in all activities of the value chain began to be considered essential. Legitimacy of plans was strengthened, various economic measures were mobilized to encourage enterprises to achieve their potential, and linkage was created between

the economic plan and the technical progress plan, and between the material plan and the value plan.

The drafting process of plans was shortened. The State Planning Committee propagated work direction and numerical indicators to be checked, which became more selective and shorter. It held guidance seminars for ministries, provinces, and cities. Ministries, general offices, provinces, and cities guided lower units, synthesized plans that had legality and self-balance, and sent them to the government and the State Planning Committee. The State Planning Committee presented the synthesized national plan to the Prime Minister, the Central Executive Committee of the Communist Party, and the Parliament. After approval, the plan was promulgated.

Some minimum and maximum plan targets were applied in the five-year plan. Material balance was calculated according to the state's minimum technical and economic norms, for both national and provincial levels. The drafters of the five-year plan were ministries, general offices, and provinces. In some cases, ministries and general offices asked large enterprises to build their own five-year plans.

Planning in the period 1975-1985 did not bring positive impact on the economy. Despite new renovating measures, the Vietnamese economy fell into recession due to the low level of the economy, heavy consequences of war, termination of external resources and some mistakes in economic policies. National income increased slowly at an annual 3.7% in the period 1976-1985. In details, national income growth was 2.8% in 1977, 2.3% in 1978, 2.0% in 1979, 1.4% in 1980, 2.3% in 1981, 8.8% in 1982, 7.2% in 1983, 8.3% in 1984, and 5.7% in 1985. Industrial output increased only 5.2% annually in the same period. In details, increases were 10.8% in 1977, 8.2% in 1978, 4.7% in 1979, 10.3 % in 1980, 1.0% in 1981, 8.7% in 1982, 13.0% in 1983, 13.2% in 1984, and 9.9% in 1985. Mistakes in distribution caused chaos in the market and led to high inflation, reaching 700% in some year. The lives of people became increasingly difficult. In the planning period 1981-1985, Vietnam had conducted two rounds of price, salary and monetary adjustments but the result did not fulfill expectation. The economy remained in recession.

## 1.3. Renovation period, 1986-now

In December 1986, the VIth Communist Party Congress evaluated the ten years of national socio-economic construction and development in 1975-1985. Some lessons were drawn and causes were discussed. This congress provided a historical turning point as it recognized the way to develop Vietnam into a new era including renovating economic mentality, developing a multi-sector commodity economy, and eliminating the centrally planned subsidy economy.

The VIIth Communist Party Congress reconfirmed that the "economic mechanism of Vietnam was the socialist-oriented market mechanism with state adjustment". This mechanism required diversification of economic sectors, equitization of SOEs, private sector development, use of the market mechanism as a tool to regulate production, and use of market prices as a basis for production, consumption and resource allocation.

Planning in this period can be characterized as follows: (i) a shift from resource allocation planning to resource exploitation planning with targets for individual economic sectors; (ii) a shift from direct planning to indirect planning; (iii) a shift from closed planning in each sector and/or province to strategic orientation with harmonization and combination among sectors and provinces.

The following documents provided the background for compiling plans.

(1) Government guidance on orientation, target and main tasks of socio-economic plan and guidelines of MPI on planning framework; Decision No.16/2000/CT-TTg dated September 19, 2000 on designing five-year socio-economic plan 2001-2005.

(2) Viewpoint and modality of the Communist Party is expressed in the Ten-year Strategy 2001-2010 including industrialization and modernization, sovereignty, proactive integration, rationalization of economic structure, and linkage between economic development and socio-cultural development.

(3) Objectives, targets, and tasks of socio-economic development

and main self-balance in the economy are used to direct the development of sectors.

(4) The current situation of each sector and region, the ability to expand domestic and foreign markets, and the ability to mobilize internal resources and attract foreign capital.

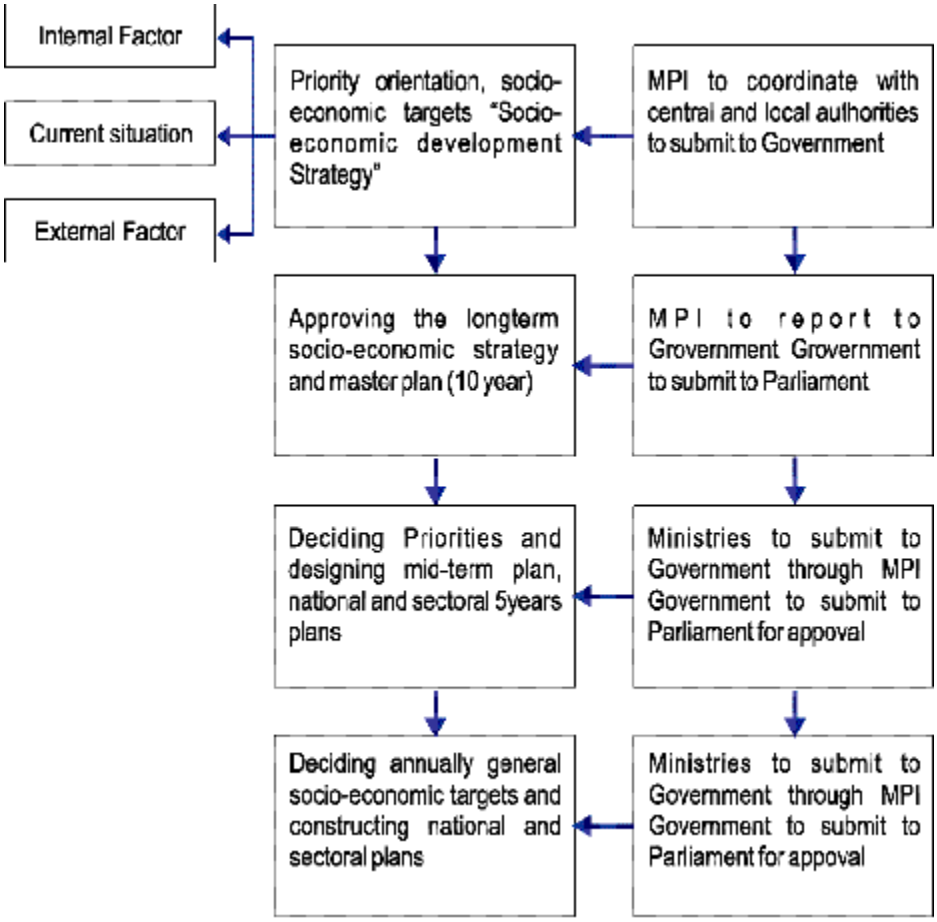
(5) Development orientation of each sector and province, and regional and sectoral master plans have been established and updated.

Planning now considers the macro balance of the economy such as labor, capital, budget and finance, etc. Its content is more closely linked with the implementation of policies. Economic and social issues are better integrated. Planning has been renovated by shifting dramatically toward oriented planning with quantitative models. Indicators such as savings, investment, ICOR, unemployment, etc. are applied. Macro planning targets such as GDP, trade balance, etc are reconstructed to follow general practices of the region and the world. Instead of top-down assigning of numerical indicators to be checked, there have been meetings to share foreign and domestic information and policies.

Sector management of each ministry has been enhanced, and discretionary functions have gradually been eliminated. The central government together with ministries are now responsible for overall master plans and consolidating and optimizing plans of general corporations and enterprises. Provinces are in charge of provincial socio-economic and sectoral development master plans. The Ministry of Planning and Investment is responsible for synthesizing and balancing the entire national plan and reporting it to the Prime Minister. The government submits it to the Parliament in the form of the Socio-economic Development Plan in the second parliamentary session of the fiscal year.

Several issues are being deliberated on the current planning method, including the role of planning, methodology of planning, content of planning, the proper way to use targets, and allocation of budget and resources.

**Figure 2-2. Designing and Approving Process (1986 - now)**




## 2. Experiences of planning in other countries

### 2.1 France: improving forecast efficiency and planning flexibility.

Indicative planning was first adopted in France. France's first five-year plan (1947-1951) aimed at recovering the economy after the War. The subsequent five-year plans up to the fifth plan (1967-1971) gave important orientations for France to achieve economic growth based on the advances of science and technology, gradually integrating the French economy into the regional and global economy. The capitalist

recession in the early 1980s highlighted the need to reform economic structure and planning. The French planning reform emphasized improving forecast accuracy and replaced long-term planning by strategic developing plans that permitted more flexible responses.

## 2.2 Japan: providing information to compile flexible rolling plans under long-term commitments

Japan is one of the typical capitalist countries that achieved a miracle in economic development by combining the market mechanism and government planning. The Japanese government began to directly control the economy in the 1930s. After WW and the dropping of two atomic bombs, Japan had lost 30% of its economic potential. In May 1948, Japan implemented the five-year plan (1949-1953) to recover the economy. After attaining economic recovery and stability, Japan terminated direct control of the economy but maintained economic planning. From then until 2000, Japan implemented 14 consecutive five-year plans.

Japanese five-year plans had the following characteristics: (i) plans were constructed by the methodology which could quickly adapt to changing domestic and international conditions, (ii) plans were always accompanied with economic policies and measures that reflected government's commitment to carry out stated plans, and (iii) plans informed firms and people of official priority in resource allocation as well as changes in market conditions.

The role of planning in the market economy was explained as follows. First, plans provided information and economic forecast which helped private firms to make their decisions. Second, plans constituted government's long-term commitment regarding goals and expenditures. Third, plans were a consistent and sufficient source of information for the government and private firms alike, creating reliable environment for production, commerce and consumption.

## 2.3 Russia: one authority exercising all planning functions

In transition to a market economy, planning remains crucially important for Russia. Concerned authorities need to predict the progress of privatization, breaking monopolies, formation of various

means of production under different ownerships, and advance of technology. Previous planning method is no longer applicable in the transition period and must be replaced by new strategic planning. Both the administrative branch and the legislative branch must take part in this. The legislative branch creates legal foundations for the state's adjustments, forecast, and strategic planning, and approves the federal budget which is the backbone of state general planning. The administrative branch, namely the government, implements planned tasks in all aspects of socio-economy. This branch includes the Ministry of Economy, the Ministry of Finance, the Ministry of Science and Technology, the Ministry of Natural Resources, the Ministry of Industry, the Ministry of Agriculture and Food, the Ministry of Fuel and Energy, the Ministry of Labor and Social Development, the Ministry of Science and Education, the Ministry of Transport, as well as the federal committees such as the Communication and Post Committee, the Environment Protection Committee, the Housing Policy Committee, the National Reserve Committee, and the Measure and Standard Committee. Among them, the Ministry of Economy stands out as the central coordinator.

The main role of the Ministry of Economy is to draft forecasts and strategic planning programs. Together with related authorities, the Ministry of Economy compiles and synthesizes socio-economic development reports for regions, industries, and economic sectors, drafts financial balance sheets to ensure a balanced budget, checks the demand-supply situations of goods markets and equilibria for essential goods, and thus plays the leading role in planning work in Russia. The Ministry of Economy guides all other related authorities for methodology, coordinates them in drafting and implementing national goals, and sets up a list of objectives with specified priority in federal budget allocation.

## 2.4 China: reducing the scope of planning and adopting indirect plans

China has a socio-economic development strategy which reflects China's unique socialism that always stresses the role of planning. Central planning has existed in China for a long time, counting 9

five-year plans. Despite some initial achievements, China's early central planning caused serious problems and the economy stagnated. The five-year plan of 1976-1980 which advocated "four modernization" ended the era of central planning.

Generally speaking, China seems to handle properly the relationship between the market mechanism and macroeconomic planning, which requires an appropriate combination of theory and practice. As to planning methodology, China has shifted from central planning to indirect development planning. The scope of planning has been reduced with an intention only to orient or guide. Previous material targets for commodities have been replaced by value targets. Allocation of targets to individual firms has been reduced, and planning gradually shifted to balancing macroeconomic indexes by applying economic forecasting models and policy instruments.

## 2.5 Korea: industrial planning is the core of planning with commitments in long-term supporting investments

South Korea implemented its first five-year plan (1962-1966) featuring import substitution industrialization strategy. Its main purpose was to produce industrial goods such as textile, shoes and food for domestic consumption. However, high GDP growth of 8.5% in this period failed to strongly upgrade economic structure or improve the trade balance. This prompted Korea to quickly move to export-oriented industrialization strategy. The second five-year plan (1967-1971) and the third (1972-1976) endeavored to develop labor-intensive industries for export such as textile, leather, wood, paper, glass, plastic, beverages, and food processing. At the same time, they also prepared for export-oriented industrialization by increasing investment in industrial foundations with high science and technology contents. Thanks to this preparation, Korea was later became one of the Newly Industrializing Countries. At the end of 2000, Korea completed the eighth five-year plan which featured modernization and trade liberalization.

In Korean planning, the government was able to build proper strategies, be flexible in responding to changes, and apply strategies

creatively. Korea's planning can be regarded as national industrial planning which succeeded in achieving strong export-led growth.

## 2.6 Malaysia: industrial master plans to promote basic industries and later to create high value-added

Malaysia's overall economic development plans carry such objectives as employment, broadening and diversification of economic structure, and economic growth through export-orientation. During the last four decades, Malaysia has experienced a series of structural shifts, moving from primary commodities to a more diversified economy with a strong industrial base.

In the early 1960s, the strategic orientation of Malaysia was to speed up import substitution in manufacturing, encourage the use of domestic natural resources, and create jobs through oil, wood, and rubber products. With adaptable and cheap labor, financial incentives, good infrastructure and political stability, Malaysia attracted a large number of foreign investors, especially in export-oriented and labor-intensive sectors such as textile and electronics. Export-oriented strategy brought a remarkable increase in exports from 22% of GDP in 1980 to 80% of GDP in 1995. Nevertheless, Malaysia is still strongly dependent on foreign technology.

In the 1980s, Malaysia tried to develop export industries and diversify economic sectors by promoting manufacturing industries that required large investments such as steel and cement, and strategic firms such as Proton, a national car project, and HICOM, to stimulate industrial development.

The Industrial Master Plan (IMP) of 1986-1995 was a landmark for government's industrial strategy. IMP was successful in accelerating growth; the manufacturing sector grew 13.5% annually and unemployment declined from 6.9% in 1985 to 2.8% in 1995. From an agriculture- and resource-based economy, Malaysia became a major exporter of industrial goods, achieving three-fourths of the way targeted by national competitiveness drive, which advocated three principles of enhancing factors [of production], investment, and reform.

The second IMP of 1996-2005 aimed at accelerating growth through the internal strength of manufacturing and, at the same time, emphasized the need to accumulate, specialize and diversify supporting industries, and strengthen linkage among them. The orientation of IMP2 was to coordinate the management of manufacturing according to the "value chain" for competitiveness, productivity and industrial linkage. The industrial clustering model in IMP2 provided theoretical solutions to the marketing problem and the creation of strong linkages and economic foundations. In other words, the industrial clustering model ensured consistency among "value chain" activities such as R&D, design, and marketing. This model also provided a theoretical basis for domestic investment, including SMEs, to achieve economic balance under regional and global competition.

Malaysia's eighth planning cycle (2001-2005) ushered in a new period in industrial development which called for stability and growth of production sectors. In this period, industrial sectors had to face new challenges from free trade and high mobility of capital, knowledge, and technology. To become a meaningful part of the global economy, Malaysian firms were asked to utilize IT and participate in e-business.

## 2.7 Philippines: combining planning with budget

Planning in the Philippines is characterized by the combination of planning with the budget in the market economy.

In 1986, to achieve higher, broader and more sustainable economic growth, the Philippine government began a structural reform program which contained short-term policies for macroeconomic stability and long-term policies to restructure various sectors. The short-term target was a balanced budget. To conduct sectoral restructuring, the government carried out import liberalization, tariff reform, and privatization of SOEs.

In 1992, the government announced the Medium-term Philippine Developing Plan (MTPDP) for the period of 1992-1998 to attain sustainable growth and social reform. In building infrastructure, essential projects were short-listed for implementation even under a

tight budget. In social reform, the plan attached priority to spending in education, health care, and poverty alleviation.

In the MTPDP of 2001-2004, the government considered reduction of the budget deficit as an urgent task. The MTPDP draft for 2004-2010, announced in 2002, continued to regard balancing the national budget as top priority.

MTPDP informs the public of the rules and policies that the authority is committing to achieve sustainable and equitable growth. The government makes adjustments using tax and expenditure policies. Financial assistance is needed in social investment such as roads, bridges, education, health care, and environment protection. Since the market does not solve the income inequality problem, without government intervention income gaps are likely to persist from this generation to the next. Subsidies are also needed in secondary and university education and vocational training. Compared with the central government, local governments better understand people's need and should be able to respond to them more quickly if they are given authority and resources.

The Medium-term Public Investment Program (MTPIP) accompanies MTPDP. This is a list of investment projects to be implemented by ministries and state organizations to realize the policy proposed in MTPDP. MTPIP sets maximum resource allocation for each sector. Within this limit, ministries and lower agencies make out their proposals. To offer additional financial support, the central government sometimes on-lends ODA funds to local governments through state financial bodies.

The Medium-term Expenditure Framework (MTEF) translates MTPIP-approved projects into annual budgets. Meanwhile, the Parliament has the right to ratify the budget. The government must somehow commit to provide funding for projects listed in MTEF even if the allocated budget is not enough for them. Although MTEF may be a good device for improving project implementation, it is dependent on the availability of fiscal resources. In addition, MTEF cannot succeed without parliamentary support.

## 3. Lessons of foreign experiences for Vietnam

Admittedly, experiences from countries reviewed above may not be enough to give an apt answer to Vietnam's industrial planning problems. Furthermore, Vietnam should not copy mechanically any given experience because background and conditions are different across countries. However, these experiences can be useful references for transition economies like Vietnam. Here is the summary of some lessons.

First, socio-economic development planning should be regarded as a series of processes. It not only proposes national agenda for development but also shares a vision on "where we are going together," and encourages all parties to take part in it. In this aspect, planning plays an important role by creating consensus and empowering all participants.

Second, a development plan itself is just a document. The success of the plan depends on the implementation which is closely related to the management capability of the state. Plan implementation should closely link planning and budget as in Korea and the Philippines.

Third, planning should be based on markets, but at the same time it should orient, aid, and encourage synchronous establishment and development of various markets including goods and service markets, factor markets, and domestic and foreign markets. In addition, it is essential to create and strengthen organizations that provide consistent and accurate socio-economic information.

Fourth, it is necessary to apply outcome-oriented planning (or target-oriented planning). This method helps planners to prepare a logical program that can incorporate consultations with concerned parties. It can also combine many targets from different levels into a system, link resource allocation with desired outcome through prioritization, and make it convenient to monitor and supervise plans. Besides this, application of computerized methods such as general growth models, IO tables, project evaluation and cost-benefit analysis, is required.

Fifth, dynamism of all economic sectors should be mobilized, in which the private sector and FDI play essential roles in achieving plan objectives. For this reason, plans need to be announced broadly to the public and call all economic sectors to join forces. At the same time, the government should build required mechanisms and a business environment that can accelerate and encourage their participation in the process of industrial development.

Sixth, since plans are built on master plans and strategies, it is necessary to improve the drafting of these documents and ensure consistency among the strategy, the master plan and the plan. Simultaneously, plan management and implementation should be guided by appropriate policy and mechanisms to mobilize all resources for development.

Fifth, it should better to exercise the whole power from all economic sectors, in which private sector and FDI play essential role in obtaining objectives. Therefore, plan need to be announced broadly to the public to call all economic sectors to take part in. At the same time, government needs to build required mechanism and create business environment to speed up and encourage them to participate in industrial development process.

Sixth, since plans are built on scheme and strategy foundations, it is necessary to succeed from construction and management of scheme and respect the systematic of planning. At the same time, plan managing and implementing should be based on policy and mechanism foundations to explore all resources for development.

# Chapter 3 Thailand

## 1. Top-down decision making

The entire working of the Thai government changed significantly four years ago when the Thaksin administration came into power and began to run the country in a new way. Previously, most Thai governments were weak and uncoordinated. But Mr. Thaksin's government is strong and decisive. He determines the general direction and orders ministries and related organizations to work out the details and implement actions. This top-down decision making is quick and affects the entire scope of policy making including industrial strategy formulation. The role of economic ministries now is to concretize predetermined policy orientation rather than build policies from bottom up. Since Mr. Thaksin was recently re-elected for the second term, this policy style is likely to continue for four more years. Further administrative reform is expected to accelerate the Thaksin policies[7].

In Thailand, the National Economic and Social Development Board (NESDB) drafts the five-year plan. The ninth five-year plan (2002-2006) is currently in place[8]. It sets an overall guideline with an emphasis on good governance, human resources, social protection, environment, macroeconomy, competitiveness, and science and technology. However, the strategic role of this plan appears to be diminishing as a result of the prime minister's strong governing style. Some even speculate that NESDB and the five-year plan will be abolished in the near future. But others note that they are still needed to balance economic and social needs and give overall consistency to policy formulation.

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[7] This chapter reflects information at the time of our visit (Feb.-Mar. 2005). Although the political situation changed in 2006, we retain our original analysis since the political change does not invalidate policy lessons we draw from Thailand.

[8] Government of Thailand, The Ninth National Economic and Social Development Plan (2002-2006), compiled by the National Economic and Social Development Board, Office of the Prime Minister.

Many officials positively evaluate Mr. Thaksin's initiative. As in many other countries, Thai ministries did not talk to each other and their policies were often contradictory and ineffective in the past. At present, policies have become more integrated under Mr. Thaksin's visions. He wants to run a country as if it were a business enterprise. Some officials boast that their decision making is now faster than private sector decision making, and dialogue among concerned ministries, domestic and foreign firms and international partners has been activated. It is said that policy direction is now much more clear and transparent.

However, critical opinions also exist. Some say that Mr. Thaksin is very good at public relations and image-building but whether his visions can be actually implemented is an entirely different matter. Some argue that corruption is still rampant or even intensifying under Mr. Thaksin's government.

## 2. Liberalization and local capability

Although the governing style of the current Thai government is centralized, it is very different from developmental states frequently observed in the history of East Asia. The governments of Park Chung Hee (Korea), Deng Xiao Ping (China), Lee Kuan Yew (Singapore), Chiang Kai Shek (Taiwan) and Dr. Mahatir (Malaysia) were more interventionist in the sense that they tried to enhance or supplement the market mechanism by a powerful state hand, fiscal and financial measures, public investment, protectionism, discriminatory preferences, and so on, with the ultimate aim of bolstering indigenous industries.

But the Thaksin government is seriously committed to international integration[9], various FTA initiatives, and equal treatment for all enterprises including domestic and foreign, large and small. Local content requirement was abolished in 2000 when WTO commitments were fully executed. Thailand has no law requiring technical transfer. We heard more than once that the current government had no interest

[9] Within-ASEAN tariffs (CEPT) for manufactured products are already very low. However, some non-ASEAN tariffs and non-tariff barriers on services are still high.

in the nationality of companies operating in Thailand, whether they are Japanese, Korean, European, American or Thai. This is in sharp contrast to most other developing countries, including Vietnam, which earnestly desire to strengthen indigenous industries. The Thai government is also uninterested in which products or companies will win competition. Its principle is "let the market decide".

However, it is not entirely true that the Thai government is uninterested in local capability. On the contrary, the main pillars of current industrial strategy are human resource development (HRD) and supporting industry promotion with a particular emphasis on small and medium enterprise (SME) promotion. While this sounds somewhat at adds with the statement that Thailand has no interest in the nationality of its industries, it is not really so. Firms operating in Thailand and Thai-owned firms should be clearly distinguished. The government wants to strengthen the former which can include any nationalities. It hopes to support several targeted industries with high domestic value (see below), but support measures will remain broad, nondiscriminatory and available to firms of any size or nationality.

This is a new style of policy formulation which may be suited to the open character of Thai people as well as the requirements of globalization. It also goes well with the policy advice of international organizations like the World Bank, IMF and WTO. It is clear that heavy-handed interventionism of Japan and Korea in the past is no longer permissible in the current international environment. In this sense, Thailand's industrial policy combining top-down liberalzation with general support measures may set a new standard for other countries to follow.

But some ambiguity remains. If Thai firms grow strongly along with foreign firms, all is well. But if local firms are eliminated and the industrial base continues to be dominated by foreign firms due to the lack of competitiveness or ineffective policy, will Thailand still be satisfied? The current government seems to be saying yes, if it is the result of global competition. But is it really politically and socially acceptable? All depends on the quality of human resources, entrepreneurship and policy measures on the Thai side. However, it is

frequently pointed out by Japanese manufacturers that Thai workers and managers have fundamental weaknesses. Can it overcome this long-term problem and realize its visions? Are today's open policies enough? It remains unclear[10].

## 3. Targeted industries and policy formulation

The current government of Thailand is fairly clear about how the country wants to position itself in an increasingly competitive world. It hopes to promote industries that have high domestic *value-added* (i.e., creating more jobs) and can find *niches* in the world economy (i.e., not competing directly with China and others). The following list more or less exhausts the targeted industries and their slogans:

Automobiles and automobile parts ("Detroit of Asia")

Agro-industry ("Kitchen of the World")

Fashion, such as jewelry, leather goods and Thai silk ("Hub of Tropical Fashion")

High value-added services, such as healthcare, spa and long-stay tourism

Electronics and ITC

Energy and renewable energy (newly added)

While the criteria for industrial targeting (value-added and niche-seeking) are well specified, the listing of targeted industries is left to each ministry and agency to decide. As a result, the names of

[10] Kenichi Ohno pointed out this "glass ceiling" problem in his VDF discussion paper, "Designing a Comprehensive and Realistic Industrial Strategy" (June 2004, pp.17-18) noting that no ASEAN countries have grown out of dependency on foreign technology and management, unlike Korea and Taiwan who can manufacture products by themselves. This issue was also raised in Industrialization Strategy of Vietnam (edited by K. Ohno and N. Kawabata, Yuhikaku, 2003, in Japanese), as follows: "Since the late 1980s, some countries have succeeded in significant industrial agglomeration including Thailand (automobile) and Malaysia (electronics)... But ASEAN has not really internalized industrial capability even after decades of FDI absorption... While manufacturing dominates economic activity, technology and management have not been localized. Since value-added tends to grow less rapidly than wages in these countries, industrialization cannot break through a certain level... To avoid this trap, a country must eventually graduate from simple processing and master skills, talents and systemic innovation. Can this be accomplished under free trade and eternal FDI-dependency?" (pp.65-66).

promoted industries and how they are grouped differ slightly from one government body to another depending on their scope of authority. For instance, "electronics and ITC" and "energy and renewable energy" are in the list of BOI but not in the list of MOI. Tourism is sometimes listed separately from high value-added services.

The policy style of Mr. Thaksin is to impose broad-and often ambiguous-visions rather than micromanage the contents of policy measures. After visions are set, relevant ministries and agencies are required to work out detailed targets and action plans. They must design, implement, monitor, revise and trouble-shoot them as necessary. For example, no one can clearly explain what the automotive slogan of becoming a "Detroit of Asia" means. But in the MOI's master plan of the automobile industry 2002-2006, several numerical policy objectives are stated (see below). Then, at the level of annual plans, concrete projects and budgetary allocation are determined. As new situations and problems arise, strategies are adjusted through ongoing consultation between the government and the private sector.

To facilitate coordination among government, businesses, and industrial experts, the Thaksin government created nine industry-specific non-profit institutes under MOI including steel, food, automobile, electronics, textile, etc. These institutes are required to play key roles in the design and implementation of Thai industrial strategies. After five years of establishment (which is about now), they are required to become financially independent from the government budget. However, whether that is really possible or even desirable is an open issue; to make enough money while contributing to the society and economy at large is a tough requirement. Other issues include whether these institutes can really play the expected role and whether their subsidized activities will not crowd out private research and consultancy. At any rate, it seems too early to evaluate their overall performance. In Vietnam, the option of creating central institutes with sufficient mandate and human and financial resources should be seriously considered. Vietnam also has many institutes and associations for each industry and under each ministry, with a pre-specified scope of research to support policy makers. Unlike

Thailand, their main purpose does not include providing linkage between the private sector and the government. Their activities often remain ineffective because information and resources are scattered.

One of the most salient features of Thai industrial policy formulation is the depth of involvement of the private sector. Policy design, implementation and adjustment are conducted through a close and continuous cooperation between the government and the business community with the private sector taking the lead. This is in sharp contrast to Vietnam where information channels between government and businesses are severely limited. In Thailand, the work on a master plan begins with the government listening to the private sector. The content and targets of the master plan are proposed by the business community. At every stage of implementation, revision and problem-solving, the private sector has many opportunities to voice its opinions. For this reason, there is very little dispute among various stakeholders once the master plan is agreed. In fact, Thai master plans do not require any official approval (like the Prime Minister's approval in Vietnam) to become effective. The official author is MOI but the ideas are shared among all in the process of drafting.

Another important initiative by the Thai government is the establishment of industry-specific government committees for individual key industries. They now meet frequently (every 1.5 months, for instance) and are actively attended by relevant officials and general directors of major producers. In these committees, current situations are evaluated, new issues are identified, and special subcommittees are set up to draft required solutions. Since the master plan sets only broad objectives, and since each committee continuously adjusts the implementation of the master plan, there is no need to revise the master plan itself. For example, the automotive master plan 2002-2006 has not been revised during implementation.

Vietnam also has official meetings between the government and investors, but they tend to be very formal and infrequent. In Vietnam, the private sector is not asked to draft a master plan at all; they are only asked to comment on the policy which the government is implementing or has decided to implement.

## 4. Automotive master plan 2002-2006

Let us examine the content of the current automotive master plan of Thailand which was produced jointly by the government and the private business community[11]. The drafting rocess took about one year. It has several characteristics that are different from the automobile master plan of Vietnam[12].

First of all, the Thai master plan is longer than Vietnam's. In the original language, the Thai version is over 300 pages, of which 60% is dedicated to tables for detailed implementation. The Vietnamese version is 63 pages long. Its executive summary version which was approved by the prime minister is 15 pages long.

The Thai master plan has the structure similar to what Ohno recommended in his MOI seminar in February 2004[13]. It starts with the analysis of the global and regional automobile industry and the assessment of current domestic capability of Thailand. Then it sets several broad numerical objectives to be achieved by 2006. Finally, the master plan contains a thick section delineating action plans to achieve these objectives.

The objectives set by the automotive master plan for 2006 are as follows (actually, these objectives were already achieved in 2005, one year ahead of the schedule):

> To produce one million cars per year (valued at more than 500 billion baht)

[11] KSOE privatization was completed in Thailand about a decade ago and all manufacturing firms are now private. The only remaining issue in SOE reform is when and how to privatize the power company.

[12] *The Master Plan for Thai Automotive Industry 2002-2006, proposed to the Office of Industrial Economics, Ministry of Industry by Thailand Automotive Institute*, September 2002. On the Vietnamese side, the relevant document is the Master *Plan for Developing Vietnam's Automobile Industry*, October 2004.

[13] Kenichi Ohno, "Designing a Comprehensive and Realistic Industrial Strategy", VDF Discussion Paper No.1, June 2004. Reprinted in VDF's *Improving Industrial Policy Formulation*, edited by Kenichi Ohno and Nguyen Van Thuong, and published by the Publishing House of Political Theory, 2005.

To export 40% of the cars produced

To produce two million motorcycles (valued at more than 100 billion baht)

To export 20% of the motorcycles produced

To export more than 200 billion baht of international quality parts

To achieve localization of 60%

Here, two points should be stressed in comparison with Vietnam's automobile master plan.

First, the Thai government only specifies total production and total exports as objectives rather than the number of cars by each category (cars with 5 seats or less, cars with 6-9 seats, less-than-2-ton trucks, 2-7 ton trucks, etc). It does not also care who (local, joint venture, or foreign firms) produce and export cars to achieve these objectives. There is no national car project or designation of individual producers. As far as objectives are concerned, there is no more detail than given above. As mentioned before, Thailand lets the market decide winning firms and products.

Second, by contrast, the Thai automotive master plan is very detailed in implementation. While the Vietnamese master plan also states supporting measures, it is only 3 pages long (Part II, chapter 4, pp.49-51). In the Thai master plan, a large number of tables are attached over 180 pages to specify strategies, action plans, output, key success indicators and responsible organizations.

The main differences between the Thai and Vietnamese automobile master plans are summarized below.

Automotive experts at Thammasat University confirmed that policy is now designed and implemented collectively and continuously between the government and private firms. Although private firms sometimes try to bargain with policy makers, severe confrontation does not happen in Thailand. According to the Thammasat University researchers, localization requirements used in the past were not effective in improving Thai capability due to loopholes in regulation and juggling by producers which only led to inefficiency. To bolster local capability, supporting local producers and inducing

foreign firms to productively increase local procurement are crucial, but the Thai government did not succeed in creating these conditions. The Thai researchers noted that Vietnam's current automobile market (about 40,000 cars per year, as against over 1 million in Thailand) was too small to require producers to procure parts locally. They felt that the Vietnamese target to raise the localization ratio from the current 20% to 60% by 2010 was "very ambitious".

**Table 3-1. A Comparison of Thai and Vietnamese Automobile Master Plans**

| | Thailand | Vietnam |
|---|---|---|
| Drafters | Joint product between MOI and private firms, coordinated and drafted by Thailand Automotive Institute | Institute for Industry Policy Research (MOI) with comments from relevant MOI departments |
| Period | 2002-2006 (synchronized with the five-year plan) | From approval date to 2010 with a view to 2020 |
| Approval | Not necessary | Prime Minister |
| Size | About 300 pages. English and Thai executive summaries are downloadable from website | 63 pages; the executive summary approved by the prime minister is 15 pages |
| Drafting time | About one year | Drafting time is specified but completion depends on the approval process |
| Broad vision | To become a "Detroit of Asia" | Contribute to industrialization and modernization, cope with integration, use international technology, etc. |
| Targets | Output, export and localization targets for 2006 are given for the entire industry (both automobiles and motorcyles) | Output and investment goals are given for each vehicle category for 2010 and 2020; localization goals for 2010 |
| Implementation details | Matrices containing strategies, action plans, output, success indicators and responsible organizations over 180 pages | Seven policy measures are presented over 3 pages |
| Designation of producers or regions | Not specified | Four SOEs and two ministries are specified, preferred regions are also mentioned |
| Mechanisms for revision and updating | Automotive Committee, Thailand Automotive Institute, other informal channels | Drafting body is responsible |

## 5. Electrical and electronics industry

The Electrical and Electronics Institute (EEI) was established in July 1998 in the wake of the Asian financial crisis. While Thai electronics exports are large (one-third of total exports), they remain unstable due to weak domestic foundations in technology and supply chain. Some electronics firms exit from Thailand and go to China. EEI is expected to assist the government and private companies to cope with this situation.

One of the major functions of EEI is the operation of a testing center for electrical and electronics products, which was taken over from another organization. The main purpose of this center is to conduct mandatory tests of products and parts, both local and imported, to protect Thai consumers. While EEI is expected to earn income from fees and charges and become independent from fiscal subsidies by now, equipment for officially required tests continues to be provided by the state. EEI received 100 million baht (about $2.5 million) from the government in the last five years, which EEI considered was small relative to its required tasks. While product tests follow international standards, EEI tests are not yet widely accepted abroad. EEI also faces tough competition from private (mostly foreign) laboratories which certify products for export.

In policy areas, EEI is executing part of the Industrial Restructuring Plan (IRP) of the government, with an emphasis on SMEs, clustering and environmental protection. While Thailand already has an industrial base in plastic and metal processing, supporting industries with higher value remain very limited. A huge technology gap still exists between local and foreign firms. The “technology foresight study” was produced by EEI with a support from Japan (JODC). EEI has also learned scenario planning with American assistance and “technology road-mapping" (TRM) from a Korean expert[14] under an APEC scheme. TRM first analyzes trends in *market, technology and product*. It then identifies the products to be produced domestically and those to be outsourced from abroad.

[14] Dr. Byeong Won Park, senior researcher, Korea Institute of Science and Technology Evaluation and Planning (KISTP).

EEI is not sure why electronics was not included in the MOI's targeted industries. However, the BOI's list of target industries does include electronics and ITC.

## 6. FDI policy

The Board of Investment (BOI) is the central agency for promoting FDI. For long it was directly under the Government Office but the recent administrative reform moved it under MOI. The policies and operations of BOI are not affected by this change, but coordination with other ministries has become a little more complicated. It should also be noted that, while FDI absorption was a top priority in the past, the current government also emphasizes promotion of domestic capability and SMEs.

In the last five decades, laws and policies for FDI attraction have constantly been revised to respond to changing development objectives and investor needs. Investment promotion laws have usually been revised every five years at the time of a new five-year plan. BOI hopes to revise the law within this fiscal year (by September 2005).

One of the differences between Thailand and Vietnam is that FDI incentives and approval are centralized in Thailand. Unlike Vietnam where local authorities can approve small FDI projects, all projects are reviewed and approved centrally at BOI. Incentives are also determined by BOI and local governments are not allowed to offer special privileges. However, FDI firms in rural areas are generally given more incentives by a zone system in which zone 1 (Bangkok), zone 2 (near Bangkok) and zone 3 (all other areas) offer increasingly generous incentive packages.

Another difference between Thai BOI and Vietnamese MPI is the strength of FDI marketing. Information on economic data, Thailand's main attractions and opportunities, promotion policies, investment incentives, international cost comparison, BOI services, approval procedure, and so on, are conveniently summarized in the brochure, website and slide presentation which are updated frequently. Investment application forms are downloadable from the BOI

website which features six languages (English, German, French, Japanese, Chinese and Thai). The slide presentation to our mission was clear and effective. BOI believes that its welcoming attitude is the greatest attraction for foreign investors. Vietnam can learn much from BOI in the area of country and land marketing.

BOI follows the government policy of openness and nondiscrimination among all businesses. Localization requirement has already been abolished. It thinks that measures to require technology transfer are "tricky" since overregulation irritates investors and causes them to leave the country.

# Chapter 4 Malaysia

## 1. The evolution of development policy

Since independence in 1957, Malaysia has attained significant industrialization and economic development. Preliminary data shows that, in 2005, per capita GDP reached $4,930 and the ratio of manufactured goods in total export was 84%. Among them, electrical and electronics (E&E) products occupied 64% of total export. Malaysia, with the population of 26 million, has successfully graduated from the status of a primary commodity-based economy into an upper middle-income industrialized country.

As industrialization proceeded and external circumstances changed, policy orientation also evolved in stages.

Initially, from 1957 to 1969, the import substitution of consumer goods was attempted under the strong performance of primary commodity exports (petroleum, tin, rubber, timber, palm oil, etc). The economic environment was largely liberal and without forced measures such as import bans or SOE creation. However, the gap between the ethnic Chinese, who were rich and urban, and the ethnic Malays, who were poor and rural, continued to grow, which erupted in the racial riot of May 1969.

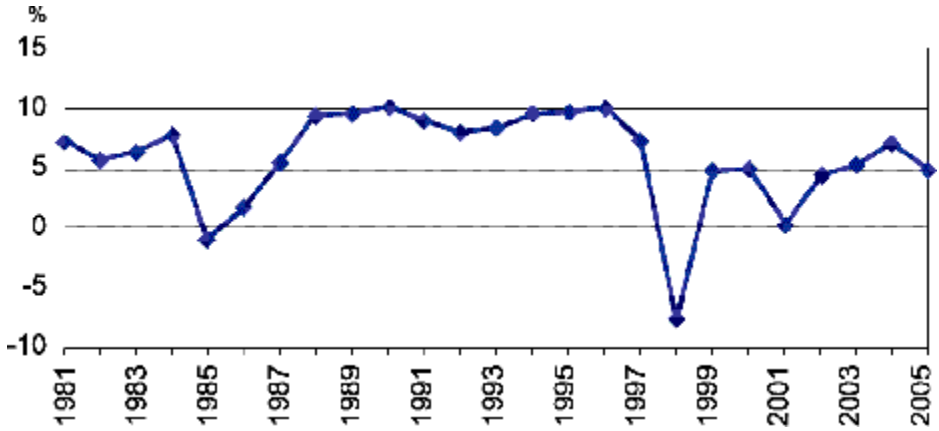
In the 1970s, a clear policy shift was made from laissez-faire to ethnicity-based affirmative actions to ease social tension and secure national unity. The New Economic Policy (NEP) imposed comprehensive rules in allocating public positions, business management, workforce, and other incentives in favor of Bumiputra (indigenous Malays).

With the coming of power of Dr. Mahathir in 1981, and under recessionary pressure of the early 1980s, aggressive industrial policy was introduced. Look East Policy and heavy industrialization, including automobiles, were initiated. With the help of the yen

appreciation starting in 1985, Malaysia succeeded greatly in absorbing manufacturing FDI and turning itself into the world's major electronics exporter. However, heavy industrialization was less successful[15].

Since 1986, policy emphasis shifted back partly from social equity to wealth creation. There was a gradual easing of Bumiputra policy, and more pro-market, outward-oriented measures were adopted. Industrial Master Plan 1 (IMP1, 1986-95) laid the foundation of manufacturing industries and promoted the processing of natural resources instead of exporting them in raw form. Industrial Master Plan 2 (IMP2, 1996-2005) tried to broaden manufacturing capability through the strategies of cluster-based industrial development and manufacturing plus plus. Industrial Master Plan 3 (IMP3, 2006-2020), which is currently being prepared, is likely to further broaden the scope by including services and featuring functional targets such as SMEs, HRD, technology, logistics, marketing, and so on. IMP2 and IMP3 will be discussed in detail below.

**Figure 4-1. Real GDP Growth**




[15] Today, few of the heavy industries prosper or even survive. Proton, the only major exception, also remains uncompetitive and faces serious difficulty as Malaysia integrates further into the global market-see below.

Many interviewees agreed that Malaysia was a lucky country enjoying political stability, strong leadership, no prolonged war of independence, a rich endowment of natural resources relative to the population size, administrative mechanisms inherited from the colonial era, high transparency and low corruption, and so forth, which enabled the country to rise to the current level. Business environment in Malaysia is ranked as one of the best in the world[16]. The timing of large FDI inflows (late 1980s) and the unique response to the Asian crisis (1997-98) may also be counted as fortunate occurrences.

The prominent feature of Malaysia is multi-ethnicity, which must be handled with care to maintain economic growth and social stability. At present, the three major ethnic groups (Malays 51%, Chinese 24%, Indians 7%) seem to live in harmony and mutual respect.

## 2. New challenges

Malaysia has achieved much, but its days of FDI-led high growth may be over. For an upper middle-income industrialized country, further development requires stepping up from mere industrial agglomeration to strengthening of domestic capability. The challenge of transition from quantity to quality is also faced by Thailand, but at a higher income level, Malaysia's challenge is more urgent. The Malaysian government is well aware of this and formulating policies to overcome it.

Like Thailand, Malaysia has absorbed manufacturing FDI for many decades, especially in E&E. FDI inflows accelerated greatly two decades ago. However, during the last decade, the Asian crisis, the rise of China, and progress in regional and global integration posed new problems which must be resolved by improving domestic capability and moving into a new development phase. However, it can be said that Malaysia, like Thailand, has largely failed in this “leveling-up” after many decades of FDI absorption-or at least its process has been

[16] The mission asked the representative of JETRO Kuala Lumpur to list main constraints for foreign investors. He paused, and replied that he could think of none as far as policies and institutions were concerned.

excruciatingly slow. To break away from foreign dependency in management and technology, and to become more self-sufficient in design, production management, marketing, and other value-creating activities is the core issue for Malaysia. The success or failure of this endeavor will determine whether its economy will continue to rise or slow down, or even stagnate[17].

Researchers at the Malaysia Institute of Economic Research (MIER) emphasized that the key problem for Malaysia was the quality of education. Under Bumiputra policy, quantitative allocation was pursued at the cost of qualitative excellence. Education in particular and the quality of human resources in general are surely at the heart of the Malaysian question. Whether this difficulty comes mainly from the characteristics of the people which are deeply embedded in society and history, or from policy inadequacy which could be amended relatively more quickly, is an open question.

Malaysia has begun to lose some FDI to China and other newly emerging destinations, including Vietnam, through relocation of existing factories and a reduced inflow of new investors. In a sense, this is natural and even welcome since Malaysia is already an upper middle-income country with relatively high wages. Labor-intensive operations should leave Malaysia, as it happened in Singapore, Hong Kong, Taiwan and Korea in the past. But at the same time, new industries and services must be created to match the now higher wages. Technology-intensive FDI should be attracted and, more importantly, local firms should innovate and produce more value. This is an inevitable process in economic development, and Malaysia should worry more about improving productivity than losing FDI to China. This is yet another way to state that building domestic capability is crucial.

[17] See the discussion on breaking the "glass ceiling" for ASEAN countries in chapter 1 (pp.24-26) of VDF's Improving Industrial Policy Formulation, edited by Kenichi Ohno and Nguyen Van Thuong, and published by the Publishing House of Political Theory, 2005. Also see the section on Proton at the end of this chapter.

## 3. Key documents

Malaysia's planning documents are organized as follows.

Vision 2020, set by Former Prime Minister Dr. Mahathir in 1991, remains the overarching national goal. It aims to develop Malaysia into a "fully developed country" by 2020 and nine challenges for this purpose are listed in general language[18]. Vision 2020 itself does not contain numerical targets, and the path and criteria to become a fully developed country are to be concretized by other documents listed below, with continuing revisions and adjustments. One practical criterion often mentioned is to surpass the per capita income of $10,000, which is supposed to be the condition to be admitted into OECD. This particular hurdle will be cleared if Malaysia sustains moderate growth in the next fifteen years[19].

Other key documents include the Malaysia Plans (MPs) and the Outline Perspective Plans by the Economic Planning Unit (EPU) of the Department of Prime Minister, and the Industrial Master Plans (IMPs) of the Ministry of International Trade and Industry (MITI). MPs are five-year plans with second-year review and a broad coverage which includes social issues and infrastructure. IMPs are documents focused on the manufacturing sector with a longer time scope, namely ten years for IMP1 and IMP2 and fifteen years for IMP3. Generally, MPs contain more targets than IMPs.

The scope of authority of the Malaysian MITI is far broader than that of the Vietnamese MOI in the sense that MITI covers international trade, FDI and SMEs, which are handled by other ministries in Vietnam. Under MITI, there are special agencies for these functions, such as MIDA (FDI), SMIDEC (SMEs), MATRADE (trade), and MPC

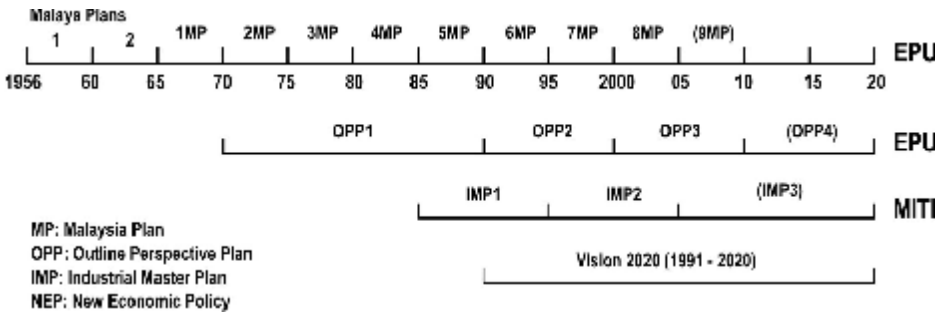
[18] The nine central strategic challenges are national unity, confidence, democracy, moral and ethics, tolerance, science and technology, caring culture, economic justice, and prosperity.

[19] Simple exponential computation shows that from the base of $4,930 in 2005, an annual average growth of 4.8% is sufficient to achieve this. However, inflation, exchange rate movement, and unexpected shocks must be taken into account. Some interviewees mentioned an average growth of 7% as a necessary condition, but we do not know where this number comes from.

(productivity). But MITI's authority is narrower than the Vietnamese MOI in the sense that it oversees manufacturing only. It does not supervise utilities, mining or construction.

IMP3 is currently in the final stage of preparation. It was supposed to be finished by December 2005 but expected completion is now moved to the spring of 2006. According to MITI, 80% is already finished and postponement is due to the time needed to obtain data up to 2005 in the remaining 20% of the draft. IMP3 is being prepared in parallel with EPU's 9MP. EPU and MITI feel that consultation between them is sufficiently frequent to produce mutually consistent output. The official language of IMPs is English.

**Figure 4-2. Key Policy Documents**



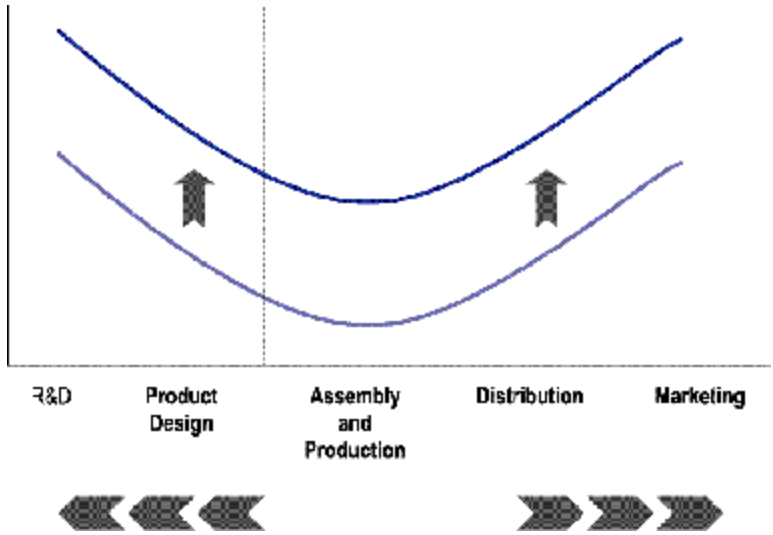

## 4. Industrial Master Plans

IMP1 (1986-95) laid the foundation for manufacturing to become the leading sector of the economy. Its main objectives were (i) accelerated growth of manufacturing; (ii) efficient utilization (i.e., domestic processing) of the nation's natural resources; and (iii) development of indigenous technological capability. The plan overlapped with a period of high growth driven by increased FDI inflows. Export growth, the share of manufacturing in GDP, and the growth of value-added in manufacturing all exceeded plan targets.

IMP2 (1996-2005), whose implementation just ended, was 453 pages long and had a clear policy orientation. The first two chapters presented challenges and an analytical framework. Its basic message

was to improve the competitiveness of manufacturing by broadening and raising its base. Its two key thrusts, which were closely related, were *manufacturing plus plus and cluster-based industrial development*.

**Figure 4-3. Manufacturing Plus Plus**




Manufacturing plus plus expresses a two dimensional desire to (i) expand along the value chain to encompass higher value-added activities; and (ii) uplift the whole value chain to raise productivity. Since Malaysia started as a conventional assembler, which was the lowest point in the value chain, it wanted to master R&D, design, product development, distribution, marketing, etc. horizontally, and also improve skills vertically.

Cluster-based industrial development broadens the concept of industry. A cluster is defined to be "an agglomeration of inter-linked or related activities comprising industries, suppliers, critical supporting business services, requisite infrastructure and institutions" (IMP2, p.23). Eight clusters were identified and analyzed in chapters 3 to 10 of IMP2: E&E, textiles and apparel, chemicals, resource-based industries, food processing, transportation equipment, materials, and machinery and equipment.

The fact that the background paper was prepared by one researcher at the Malaysian Institute of Economic Research (MIER) perhaps gave IMP2 a lucid academic style[20]. In more common language, this framework is basically saying that Malaysia must enhance competitiveness, improve productivity, and promote supporting industries and related services. But placing them in value-chain language provided more focus and consistency.

The mission raised three questions regarding IMP2: (i) application of one analytical procedure to all industries seems too mechanical and ignores specific features of each industry; (ii) there is no selectivity since eight clusters cover virtually all key industries of Malaysia; and (iii) aiming to broaden and raise all industries and related services is a full-set orientation which goes against international division of labor under globalization and FTAs. Some officials replied that these concerns were not addressed at the time of drafting IMP2, but they thought that the analytical framework was flexible enough to accommodate global linkage or each industry's specific issues.

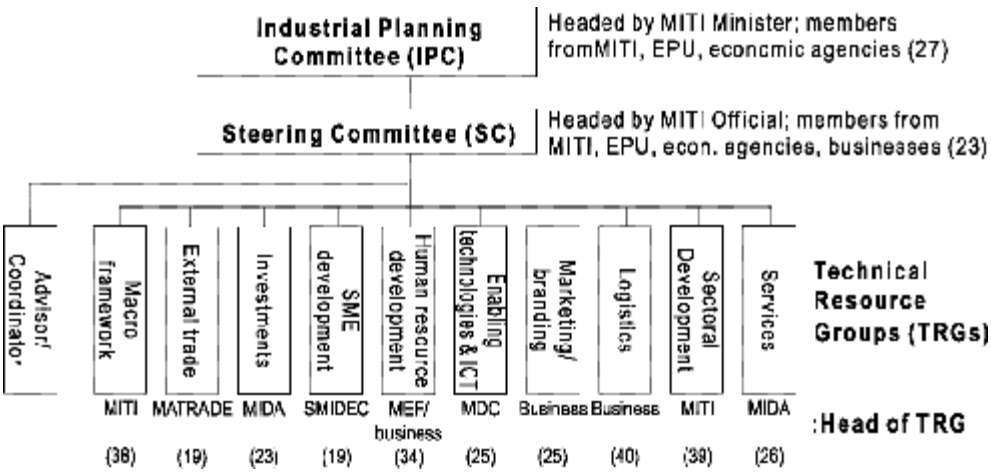
IMP3 (2006-2020) is in the final stage of preparation and its content has not been released. However, MITI officials discussed its general orientation. Its objective will continue to be achieving international competitiveness under global integration. IMP2 tried to strengthen clusters across the board and IMP3 will also continue to do so, with added emphasis on inter-cluster linkages. At the same time, IMP3 will introduce some new elements. It will designate subsectors within each cluster to be targeted more selectively. For example, within E&E, nano-technology, photonics, microelectronic mechanisms, etc. will be listed. Bio-technology and pharmaceuticals will also be mentioned. There will be more emphasis on services such as marketing, utilities, environment, and attracting regional headquarters and international procurement offices (IPOs) to Malaysia. Human resource to carry out innovation will be promoted. “Networking” (any form of cooperation between local and foreign companies) and “cross-border investment” (outward FDI) will also be featured.

[20] By contrast, IMP3 has been produced in a more decentralized fashion, with each chapter written by a different group without a common structure imposed from above-see below.

## 5. Drafting and review processes

IMP2 and IMP3 were prepared by a three-level organization. Figure 4-4 shows the case of IMP3. Teams at the bottom level correspond to proposed chapters. IMP2 was drafted by a similar mechanism, but the three levels were then called, from top to bottom, the Industrial Coordination Council, the Industrial Policy and Incentive Committee, and the Industry Task Forces.

**Figure 4-4. Drafting Mechanism for IMP3**




Source: MITI website

Note: Numbers in parentheses indicate the number ofmembers in each committee or group

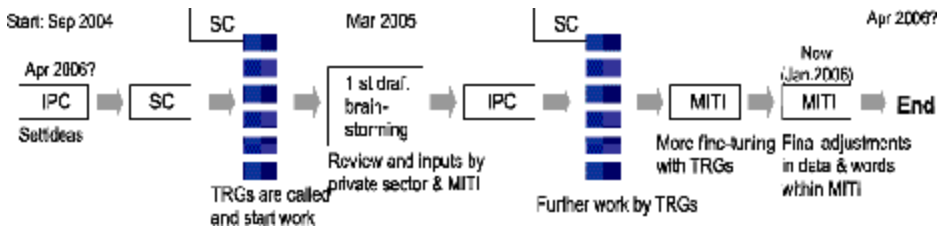
The total number of people mobilized in the three levels was 338 although there are some overlaps among members. Besides this, under each Technical Resource Group (TRG), secretariat, writers, research assistants, and so on, were arranged as needed. Under the general guidance and coordination of the Steering Committee, how each chapter was drafted was largely left to each TRG.

Compared with Vietnam where small official teams draft master plans, this is a very complex organization. The mission asked how consistency was ensured under this system involving a large number of people. The general answer from concerned officials was that, since communication among relevant ministries and agencies was active,

information was shared and potential conflicts were solved in daily contacts, and there was little scope of remaining serious differences by the time an IMP began to be drafted. Since various views, including those from businesses, are absorbed in advance, top-down directives do not generate any friction at lower levels. This sounds ideal, but we did not have sufficient time to confirm that the process actually proceeded as smoothly as described. However, it is undeniable that inter-ministerial consultation in Malaysia is far more frequent and effective than in Vietnam.

More specifically, MITI officials explained the process of drafting IMP3 as follows.

**Figure 4-5. Drafting Process of IMP3**




The overall direction of IMP3 was initially set by the Industrial Planning Committee (IPC) headed by the MITI minister. Ideas emerged naturally from many previous meetings. Unlike IMP2, they were not formed by one person or one report. There was no serious disagreement about the content. After this, the Steering Committee (SC) was set up. SC in turn established TRGs and coordinated drafting. TRGs submitted first drafts to the MITI secretariat, which were reviewed by the private sector as well as within MITI. There were no foreign experts at IPC, SC or MITI level, but TRGs were free to invite them if necessary. The private sector was deeply involved through TRGs and at the first-draft brainstorming. Many issues were raised by the private sector, while MITI tried to add long-term policy concerns. The budget for conducting the whole process was probably RM5-10 million, of which RM2-3 million went to fees and publication[21].

[21] One US dollar is approximately 3.7 Malaysian ringgit.

The mission also met with the writers of chapters in three TRGs: macro-framework, SME development, and marketing and branding. The positions of the writers varied from public servant to researcher and private consultant. Each team had a series of intensive meetings and the drafters worked hard with little remuneration. In the case of TRG on SME development, work began in July 2004 and the draft was completed in December 2005. Members met monthly over eight months to discuss different aspects such as marketing, technology, and finance. Coordination among related agencies required effort. Theoretical ideas by academicians had to be modified for more practicality. TRG also requested the Department of Statistics to conduct a new business census since data on SMEs was lacking or out of date. The writer had to draft the chapter while doing her regular work, which she said was very tough.

The co-writers of another chapter were worried that IMP3 had much less focus than IMP2 because there were "too many cooks". They thought that MITI should have steered the process more effectively to keep wild ideas away and produce clear messages. They also felt that fixation with Vision 2020 was inappropriate and the planning period of fifteen years was too long and impractical. They reported difficulty in obtaining necessary data.

Compared with the drafting process, implementation and review processes are less well-organized. IMP3 does not contain detailed action plans or policy matrices. It may contain a chapter on implementation, but this will not be detailed. Concrete implementation is left to annual budgets, MPs (five-year plans), and measures of relevant committees, ministries and agencies.

Similarly, there is no structured mechanism to monitor, assess, or revise an IMP. IMPs are not revised during implementation. MITI officials we met expressed satisfaction with the performance of IMP2, but it is also reported that the MITI Minister herself was unhappy with some aspects of the result. More than one observer outside MITI, belonging to different organizations, also felt that IMP2 fell short of achieving targeted cluster development.

A number of people told us that IMP2 had not been reviewed but IMP3

would be reviewed every five years. In fact, according to the MITI website we witnessed in 2005, IMP2 did have a mid-term review in 2001 where numerical targets and cluster-based industrial development were assessed, and actions to improve the performance were proposed[22]. The final review of IMP2 may now be similarly conducted. But the fact that most people do not recall the mid-term review of IMP2 suggests the amount of attention that it receives.

The lack of proper review may be considered a serious flaw in the Malaysian IMP. It may lead to missed lessons and insufficient design in the future. However, it may also be argued that spending more time on designing new policies than evaluating old ones is natural and understandable. If new challenges are already identified in daily contacts among officials and with the private sector, as the Malaysian officials claim, resources should be directed mainly toward meeting these challenges rather than assessing the goals which were set ten or fifteen years ago and may now be obsolete. On this issue, the mission remained divided. We can at least say that proper balance between design, implementation and review is essential since time and resources are limited.

Another related question is how we should interpret missed targets. Some macro targets of IMP2 such as growth were underachieved, and the desired domestic investment share of 60%, as opposed to FDI, was not realized. However, it is fairly clear that this was largely due to external shocks, especially the Asian crisis and the rise of China. It is hard to quantify the effects of policy weakness relative to external circumstances. If the latter is dominant, scrutinizing past policies may not produce a proper response.

[22] In the first five years of IMP2, the following targets were met or almost met (targets in parentheses): manufacturing export growth 16.6% (16%), annual manufacturing investments RM27.4 billion (RM25 billion), and the employment share of manufacturing 27.6% (27.9%). Two clusters achieved targeted value-added shares and three clusters had high productivity growth. Capital investment per employee rose remarkably in three clusters. On the negative side, R&D remained low at 0.5% of GDP, researchers and skills remained scarce, and the number of local patent registration was small. Only 20% of manufacturing firms undertook innovation. Participation in global supply chain was weak, and ICT and integrated logistics were not used widely. This information was obtained from www.miti.gov.my/miti-imp3speech, which now is removed.

## 6. FDI policy

The Malaysian Industrial Development Authority (MIDA) is the central agency for FDI promotion, equivalent to the Board of Investment in Thailand. It is one of the agencies under MITI. Although it reports to MITI, it enjoys relative policy autonomy. As Malaysia's industrialization deepens, wages rise and labor shortages have become a problem, MIDA recently acquired a new mandate to encourage "cross-border investments" (outward FDI) by Malaysian companies. Since March 2004, it also promotes services (except finance and utilities, which belongs to other agencies). MIDA wants labor-intensive industries such as garment to leave Malaysia and become global. Instead, Malaysia wishes to attract targeted high-tech FDI.

Incentives include pioneer status, investment tax allowance, and reinvestment allowance. Regionally, two levels of incentives are given, the one for the Kuala Lumpur, Johor Baru and Penang areas and the other for the rest of the country. In addition, MIDA can offer "pre-packaged incentives" (customized special deals) to attract targeted FDI firms individually. MIDA approves all FDI projects at the federal level and provides various post-investment services. If any problem arises between a company and a local authority, MIDA solves it for them. Tax incentives are centrally administered by MIDA, but thirteen states (local governments) can offer other incentives related to land and water, such as better conditions for lease, rent and location. Incentives are given to domestic and FDI companies without discrimination. After the Asian crisis, Malaysia now accepts 100% foreign-owned projects regardless of how much the company exports.

MIDA feels that it works very closely and effectively with concerned bodies such as the Ministry of Finance (MOF), the Department of tatistics, other agencies under MITI, and foreign chambers of commerce. Every Thursday, MIDA holds meetings to approve projects and decide incentives. A representative from MOF sits in these meetings and can approve proposed tax incentives on the spot. If there is any doubt, the proposal is reported to the higher level of MOF and the issue is resolved in the following week. Such quick decision making among related economic ministries is unimaginable in Vietnam at present.

## 7. SME policy

The Small and Medium Industry Development Corporation (SMIDEC) is another agency under MITI. There are forty agencies in charge of SME promotion in Malaysia. Eighteen ministries are also involved. SMIDEC plays the leading role among them.

In Malaysia, the number of manufacturing SMEs and their production share have increased over the years. In 2004, they accounted for about 30% of output, 25% of value-added, and 32% of employment in the manufacturing sector. However, all of this growth cannot be attributed to policy measures, since private sector dynamism and external circumstances should have certainly influenced the result as well.

A number of grants, soft loans and incentives, such as higher income tax threshold, pioneer status with full tax exemption for five years, and investment tax allowance, are offered to manufacturing SMEs with at least 60% Malaysian equity[23], shareholders' funds not exceeding RM80,000, and value-added of at least 15% or contribution to rural development. Preferences are given for taking specified actions under proper documents ("concept papers") for strengthening industrial linkage, logistics services, overseas marketing, business planning, product and process improvement, obtaining quality certification, etc. The list of eligible activities is long. Proposed actions are monitored after 3, 6 and 12 months and benefits can be withdrawn if they are not implemented. It is clear that Malaysia supports SMEs mainly for achieving excellence, not just for the social protection of small firms. Currently, policy is evolving toward supporting SMEs in services in addition to manufacturing.

The mission asked if application procedures for grants and incentives were not too complex. SMIDEC admitted that sometimes public awareness of their policies was low and applications for incentives

[23] SMIDEC clarified that all Malaysian SMEs regardless of ethnicity were eligible for support. However, another source reported to the mission that only indigenous Malay SMEs were promoted. We cannot explain the cause of this discrepancy. It may come from the gap between stated policy and actual result.

were few. In such cases, it reviews procedure and regulation to see whether the problem is on the SMIDEC side.

## 8. The automobile industry

Proton, established in 1983 and started operation in 1985, is Malaysia's national car company. It has served as a key instrument for implementing heavy industrialization and IMPs. Starting from the CKD production of Mitsubishi Lancer, it subsequently internalized capability in styling and design, platforms, engines, logistics, marketing, etc. It also acquired cooperation with Lotus, a British car maker. Proton is expanding from its original three factories to Proton City in Tanjung Malim with more automation. It employs 10,000 people directly and has created an estimated 100,000 jobs through the value chain.

The domestic automobile market in Malaysia was about 519,000 units sold in 2005, of which 72.8% was passenger cars and 27.2% was commercial vehicles. In the passenger car segment, Proton holds the top share of 41.5% (Jan.-Oct. 2005), followed by another local company, Perodua[24], with the share of 33.1%. The rest is supplied by foreign-brand manufacturers. Proton procures about 5,000 parts locally from 286 suppliers, of which SMEs account for 55%. 20 vendors have the capability to design parts.

Given its large domestic market share, the quality of Proton seems acceptable to Malaysian consumers, at least as popular vehicles. But the mission also heard negative comments about its quality. The greatest problems for Proton are small domestic market size and the lack of brand recognition abroad, which together limit its production scale and raise its cost. Malaysia is now drafting a new national automobile policy, to be completed in a few months. While it has come

[24] Perodua was also established by the government in 1990s with Daihatsu as a partner. Unlike Proton, it undertakes assembly without acquiring design capability. Initially, there was a market division between Proton (over 1,000cc) and Perodua (below 1,000cc). But this division is now broken and the two companies have become competitors in the domestic market.

a long way to accumulate domestic capability, the current level is not enough to compete squarely with big international names under accelerating global competition and industrial reorganization. For survival, Proton desperately needs strategic alliance with one of the large foreign producers. Under such alliance, products should be re-targeted to specific parts and selected car models for particular markets, and to become a crucial link in the global production network. However, as the recent breakup with VW shows, it is extremely difficult to reconcile national aspiration with the prospect of foreign dominance in management.

Malaysia developed the automobile industry by internalizing capability quickly with strong official support. But it has hit a thick wall due to limited scale and severe international competition. On the other hand, Thailand created a relatively free environment for FDI car makers to achieve production size, quality, and even exports. Its problem, however, is the slow pace of domestic capacity building and the continued dominance of foreign design and technology[25]. Both paths are fraught with difficulties, but the key question is which path is more likely, under appropriate policy, to establish a competitive automobile industry in the long run. The fact that discriminatory measures are no longer permitted under WTO and FTAs also must be taken into account when Vietnam formulates its automobile industry policy.

[25] In this respect, Malaysia's E&E industry is closer to the Thai automotive industry than Proton.

# Chapter 5 Japan

Japan is a very important trade, investment and aid partner for Vietnam as well as the leading nation in East Asia's dynamic manufacturing network. The mission fully recognized, even before departure, that Japan's past and current experiences could not be applied directly to Vietnam because of different development stages and socio-economic circumstances. In this sense, Thailand and Malaysia offer more directly relevant information for Vietnam than Japan. However, the mission believed that valuable lessons could still be had from Japan if proper modifications were made. The mission succeeded greatly in obtaining such important insights.

## 1. METI's role

The Ministry of International Trade and Industry (MITI) is considred to have contributed to Japan's rapid industrialization in the postwar period from the mid 1950s to the early 1970s, although the exact extent and scope of this contribution is still debated. Most economists agree that, while private dynamism was central, MITI also played an important assisting role. On the other hand, the view that the Japanese economy was orchestrated by a strong government dictating businesses what to do, a view sometimes expressed by foreign observers, is not supported. As time passed and the Japanese economy achieved high industrialization and maturity, the role of MITI also diversified into environment, energy saving, safety standards, trade negotiation, intellectual property rights, regional cooperation, and so forth. The overall influence of MITI on Japanese industries also declined as large private firms became competitive and globalized. In 2001, the government reorganized MITI into the Ministry of Economy, Trade and Industry (METI)[26].

[26] We use the term MITI in discussing the past and the term METI for more recent situations. However, the basic policy orientation of this ministry did not change by the name change in 2001. For this reason, it is acceptable to use the two terms interchangeably.

Even in the high growth period from the mid 1950s to the early 1970s, MITI's main role was to coordinate and support private activities rather than dictating them. For declining industries, MITI intervened more strongly in order to downsize and restructure them. MITI also supported R&D in next-generation technology, but not always with success. In the case of Japan's highly competitive industries such as consumer electronics, cameras, watches, automobiles and motorcycles, MITI's role was small. Private firms were the driving force of these industries. MITI sometimes tried to reorganize their industrial structure but such efforts often failed to materialize or were rejected by the private sector For example, in the early 1960s, Japanese automobile firms resisted MITI's intension to merge them into a few large firms to compete with Americans. It is important to have a balanced view of the role of MITI (METI) in the history of Japanese industrialization. It should be neither overestimated nor underestimated.

In the automobile and IT industries (the two METI divisions we met), the role of the government was relatively modest. In the case of automobiles, METI has had no major role in deciding output, investment, product design or global strategy of Japanese MNCs. This has been true not only today but in the past as well. METI's concern has been various surrounding issues of the industry including air pollution, fuel efficiency, trade negotiations and improving business environment in the East Asian region (sometimes using ODA). These are the areas that cannot be handled by individual companies due to externality or the need for diplomatic leverage. Although Japan had serious air and noise pollution, traffic accidents and congestion due to heavy automotive use in the past, it never imposed any numerical restriction on automobile production or registration. The METI officials we met stated clearly that such restriction would violate the basic principle of free enterprise. It said that road safety and congestion was a traffic control problem of the government, not a problem of private companies that produce automobiles.

In the case of IT, the METI's role was somewhat greater than in the case of automobiles in creating a vision and setting and revising targets. This reflects the fact that IT is a fast evolving industry requiring huge investment and constant adjustments in law and regulation in

comparison with the automobile which is a relatively mature industry. But it should also be noted that METI's policy touches only part of Japan's entire IT industry, which accounts for over 8% of GDP[27]. METI's current policy in this area is the e-Japan Strategy initiated in 2001. This strategy aimed to make Japan a top IT nation by 2005. However, the target for IT infrastructure (fastest and lowest-cost broadband access in the world), which was one of the four original targets[28], was already achieved in 2003. Subsequently, the main concern shifted to the active use of IT by the general population. While METI is relatively more influential in IT than in automobiles, the government still remains a follower of industrial trends and opinion rather than an enforcer of a strategy in a top-down manner. METI continually listens to the views of the industry and experts in formulating and revising e-Japan Strategy, as we will see below.

Clearly, the government's supplementary role in industrialization reflects the very strong dynamism and competitiveness of Japanese manufacturing enterprises. MITI had to carefully listen to and work with the private sector and implemented policies that were really desired by the industry. In rare cases where MITI tried to intervene in the strategy and organization of private enterprises against their will, policy was not effective.

[27] Japan's IT industry is divided into (i) contents and platform (cable TV, mobile phone service, broadcasting, etc); (ii) hardware (computers, mobile phones, audio-visual equipment, consumer electronics, etc); and (iii) information service (system maintenance, software production and sales, information processing, etc). The value of these segments amounted to 19 trillion yen, 9 trillion yen and 14 trillion yen respectively in 2003 with the total of 42 trillion yen (this may contain some double-counting if purchasers are not final consumers). Japan's GDP in 2003 was 502 trillion yen.

[28] The other three original targets were e-business, e-government and human resource development (IT training)-see Table 1 below.

## 2. Channels with the private sector

To play a role appreciated by businesses, MITI needed effective communication channels with them. In fact, MITI's strong and multi-faceted linkages with the private sector in the past were a favorite research topic of foreign scholars such as Chalmers Johnson, Daniel Okimoto, the World Bank, and Campos and Root[29]. At present, METI still maintains many communication channels inherited from the MITI days although the private sector is now relatively more independent from METI compared with the past.

Deliberation councils still play an important role in linking government, industry and experts and in generating consensus and solving problems among them. Special committees and study groups also play a similar role. Whatever the name may be, the mechanism for listening to the industry's needs and opinions before making a policy is well established in Japan. These councils, committees, and study groups meet as frequently as necessary and produce reports to identify new issues and map out future directions.

In addition to councils, committees, and study groups set up by the government, industrial associations such as the Japan Automobile Manufacturers Association (JAMA) and the Japan Electronics and Information Technology Industries Association (JEITA) provide permanent bridges between the government and businesses. METI usually works with industrial associations to gather information and formulate policies. METI also contacts individual companies by telephone, email and informal meetings as needed. Before going to an FTA negotiation, for example, METI approaches businesses through an industrial association and individual contacts to determine Japan's negotiating position. In the case of introducing a new law, the draft is routinely discussed in an official open committee attended by

[29] See Chalmers Johnson, MITI and the Japanese Miracle: The Growth of Industrial Policy, 1925-1975, Stanford University Press, 1982; Daniel I. Okimoto, Between MITI and the Market, Stanford University Press, 1989; World Bank, The East Asian Miracle: Economic Growth and Public Policy, Oxford University Press, 1993; and Ed Campos and Hilton L. Root, The Key to the Asian Miracle: Making Shared Growth Credible, Brookings, 1996.

concerned businesses and experts. The draft law also receives public comments for at least one month.

Japanese enterprises are required by law to report basic data such as production, sales and exports to the government every month. However, data collected by industrial associations are usually faster than official data. When METI needs special or sensitive data from enterprises, it must explain the reason. Enterprises cooperate only when they agree with the purpose of such data collection.

## 3. Quick implementation and flexible revision

METI's industrial strategy is frequently reviewed and adjusted. In the case of the IT industry, strategies are revised every one to three years depending on the targeted product or service. Let us take e-Japan Strategy mentioned above as an example.

Table 5-1 shows the evolution of this strategy from January 2001 (establishment) to September 2004. Within this 45-month period, key targets were revised annually and new goals were introduced constantly. Two new bodies were created to revise the strategy. In light of early achievement of the initial targets, the completely revised e-Japan Strategy II was formulated in July 2003. Although IT is an area in which speed is essential, it must be admitted that METI's policy formulation and execution is extremely fast and flexible. Moreover, agreed actions are immediately put into practice without delay. This is in sharp contrast to Vietnam where the process of drafting and approving industrial strategies and master plans normally takes years, and implementation is often delayed while operational rules and regulations are being prepared. In the fast-changing IT industry, five-year or ten-year targets are not meaningful since it is hard to predict the industry's direction beyond immediate future.

The VDF-MOI mission has found in all of the countries it visited, namely hailand, Malaysia and Japan, that effective industrial policy formulation requires constructive and continuous contacts with businesses and a mechanism to frequently review and flexibly adjust the policy in implementation. Without these, policy becomes too slow and out of synch with the requirements of the industry.

**Table 5-1. Evolution of Japan's IT Policy in Recent Years**

| | Activity | Outcome |
|---|---|---|
| | **e-Japan Strategy (Jan.2001-)** | |
| Jan.2001 | IT Basic Law & IT Strategy Headquaters established | |
| Mar.2001 | "e-Japan Key Targets" decided: (1) infrastructure, (2) e-business, (3)e-government, (4) HRD; to become top IT nation by 2005 | Infrastructure target achieved by 2003 |
| Jun.2002 | "e-Japan Key Targets 2002": (1) fast internet 30 million households, (2) very fast internet 10 million households, (3) 98% electronic application & reporting to government by end Fy2003 | Achieved by 2003 |
| Sep.2002 | Special Study Council established to map out new strategy | |
| | **e-Japan Strategy II (Jul.2003-)** | |
| Sep.2002 | "e-Japan Key Targets 2003": In creasing IT use in (i) seven leading areas: health care, food, life. SME, finance, learning, jop, public service; (ii) five cross-cutting areas: next-generation infrastructure, security, R&D, HRD, international strategy | |
| Sep.2002 | Evaluation Special StudyCouncil established | |
| Sep.2002 | e-Japan Strategy II Acceleration Package decided: Asia & global strategy, security contents, deregulation evaluation, e-government | |
| Sep.2002 | ESSC's first report | |
| Sep.2002 | "e-Japan Key Tagets 2004": reflecting Acceleration Package above; numerical targets introduced for improving life quality and enhancing firms' competitiveness; to remain top IT nation after 2006 | |
| Sep.2002 | ESSC' s second report | |

Source: METI Commerce and Information Policy Bureau

## 4. Numerical targets

One of the questions raised by the VDF-MOI joint research is how Vietnam should use numerical targets in industrial strategy formulation in the future. It is clear that setting rigid numerical targets for all industries and products and requiring them to be met by any means is no longer appropriate in an economy under market-

orientation and global integration. But this does not mean that all numerical targets must be abolished. Thailand uses numerical targets for the total output and exports of automobiles and motorcycles, and Japan currently uses numerical targets for the household use of broadband internet and the promotion of e-government. Which numerical targets are appropriate and which ones are irrelevant and even harmful?

In reality, Vietnam's policy making is shifting gradually away from rigid targets to softer guidelines and recommendations. However, quantitative mentality is deeply entrenched from the days of economic planning and difficult to overcome immediately.

**Table 5-2. Three Characteristics of Numerical Real-sector Targets**

| Hardness | Aggregation | Periodicity |
|---|---|---|
| Legal order | Macro level (GDP, total export) | 5 to 10 years ahead or longer |
| ↕ | ↕ | ↕ |
| Indicatice targets | Sectoral (manuf./agri./service, SOE/FDI/Priv, etc) | 2 to 3 years |
| ↕ | ↕ | ↕ |
| Business plans by firms or industries | Industry level (automobile, steel, garment, electro. etc) | Annual |
| ↕ | ↕ | ↕ |
| Forecasts | Product level (cold rolled steel, camera, engine, etc) | Monthly & quarterly |

For the rethinking of numerical targets, it is useful to classify them into different groups. Table 5-2 shows the hardness of targets, the level of aggregation and the periodicity of revision as three key characteristics of real-sector numerical targets. This framework allows us to selectively adopt numerical targets rather than accepting or denying them in totality.

Under economic planning, hard numerical targets commanded all levels of aggregation from macro to product level, with five-year plans and annual budgets as key planning cycles. Under market-orientation and international integration, however, legally binding targets are no longer feasible or desirable. Numerical targets should be much less in number and remaining ones should be of the other three types (indicative targets, business plans, or forecasts).

Long-and medium-term targets on GDP growth, overall export performance or industrial structure may still be adopted, but they should be indicative without legal obligation. At the sectoral and industry levels, the appropriate choice of targets depends on the nature of each sector or industry. For material industries supplying mainly domestic markets such as steel, cement and power, numerical targets based on realistic demand forecast scenarios are still useful. But private enterprises, not the public sector, should gradually become the major supplier, and policy should shift from direct intervention like price and investment control to indirect coordination of the industry's interest such as drafting reports and master plans, and strengthening human resources, supporting industries, marketing, procurement, and so on.

For processing- or assembly-type export-oriented industries such as electronics, motorcycles, automobiles, garment, footwear and food processing, collective numerical targets are less meaningful and should be indicative at best. The effort of individual producers and global market competition should determine quantitative performance, and the main goal of enterprise managers should be innovation, competitiveness and strategic positioning rather than achieving predetermined numerical targets regardless of demand. Furthermore, for dynamically evolving industries like IT, software and consumer electronics where new products and markets merge constantly, quantitative forecasts beyond a few years are largely meaningless.

## 5. Vietnam in global and regional competition

Japanese MNCs are striving to expand their business operation in highly dynamic and competitive global markets. Whether they invest in Vietnam is not a bilateral consideration between Vietnam and Japan but one move among many to take a strategic position in the context of global innovation, production and marketing. While improving Vietnam's business conditions is important, this effort must always be made in full understanding of Vietnam's position in the global and regional business environment. Even if Vietnam improves its investment climate, that will not necessarily accelerate FDI inflows if the speed of improvement is slower than in other host countries or if improvements are made in the areas that do not interest foreign businesses.

The importance of evaluating Vietnam in the context of global and regional business strategy was clearly shown in the following three meetings.

First, the Japan Bank for International Cooperation (JBIC) explained the results of the annual survey of Japanese manufacturing MNCs to the mission. According the latest surveys in 2003 and 2004, Vietnam was the fourth most popular FDI destination for Japanese MNCs after China, Thailand, and the US. But unlike China, Thailand, and the US, Japanese MNCs had few concrete plans to invest in Vietnam although general interest was high. This was partly because Vietnam was a relatively new FDI host country and it would take some time for Japanese companies to gather information and draft business plans. Japanese MNCs lauded low-cost labor, market potential, and human resources as three attractive points of Vietnam, while the weaknesses in the legal and policy system and insufficient infrastructure were the main drawbacks in comparison with other FDI destinations.

Second, Mr. Susumu Sanbonmatsu of the Research Institute of Economy, Trade and Industry (RIETI) under METI discussed the strategic dynamics of Japanese MNCs. In his research, key strategic ingredients are markets, product line, and value chain positioning. To introduce new products for each major market continuously, MNCs must always plan and invest ahead (*global innovation chain*). Moreover, for high-quality, low-cost, and speedy production, MNCs must allocate different functions and processes to various countries

correctly (*global supply chain*). In all this, management leadership and corporate culture play very important roles. The essential point here is that MNCs come to Vietnam if that improves their performance in global innovation chain or global supply chain. The government must know what Vietnam can offer to attract them when it launches an FDI marketing campaign.

Third, Honda Motor Company explained its business situations and strategy to expand Asian production[30]. Recently Honda received a license to produce cars in Vietnam, for which the company was grateful. Honda hopes to build good relations with MOI in particular, and with the Vietnamese government in general, to realize Vietnam's potential with rising income and highly skilled labor. For motorbikes, India, China, Thailand, Indonesia, Philippines, and Vietnam are the key production sites of Honda. For cars, China and Thailand are particularly important in East Asia. When car production starts in Vietnam, Honda plans to assign Vietnam to produce certain parts for global export. Honda already exports automatic transmission from Indonesia to Asia, EU and US, and its plant in the Philippines also exports manual transmission to global markets.

## 6. Partnership based on business architecture

The mission also exchanged views with Prof. Takahiro Fujimoto of Tokyo University at his project office. He is the leading Japanese authority in business architecture theory and his current research documents the integration-based manufacturing system which is at the heart of Japan's competitiveness[31]. For this purpose, sixteen Japanese MNCs such as Toyota, Canon, Honda, Matsushita, and Sony cooperate with this project.

[30] Our discussion contained many concrete actions that Honda planned to undertake in the near future whose details cannot be reported here.

[31] Business architecture is divided into two main types: *integral* (creating original parts for each product) and *modular* (combining common parts available in the market). Japan's competitive firms often exhibit integral architecture while Chinese firms usually have modular architecture. However, not all Japanese firms are competitive or integration-based. According to Prof. Fujimoto, about half of Japanese firms are globally oriented and only 10-20% have integration-based manufacturing.

According to Prof. Fujimoto's theory, comparative advantage is created when the organizational capability of an enterprise or a country is matched properly with the architectural property of its product (integral or modular). Production partners should also be selected appropriately from the viewpoint of business architecture. Japan is an industrial country with integral capability while the US is an industrial country with modular capability. The US and China are appropriate production partners since they are both modular. Japan and ASEAN countries would also become good partners if ASEAN improves integration-based manufacturing capability. On the contrary, if ASEAN pursues modularity-based production (copy production with low quality and low price under excess competition), it will lose out to China since China is much bigger and better at modular manufacturing than ASEAN (see Figure 1-3 in chapter 1 of this book).

Vietnam must shift from modularity-based businesses to integration-based business in order to avoid direct confrontation with China and to build a more productive relationship with Japan. Prof. Fujimoto emphasized that Vietnam should learn the skills suitable for integration-based manufacturing. The government and donors (including Japan) should also support this effort in the private sector. More specifically, local capability in product design and engineering must be raised in a way directly linked to production processes. Human resource development for the purpose of high-quality manufacturing is particularly important. In fact, these are exactly the targets that Japanese firms are trying to achieve and what the Japanese government has been helping with its technical assistance programs in ASEAN. However, Prof. Fujimoto's theory puts these ongoing efforts in a new theoretical perspective[32].

[32] Ohno previously argued that Vietnam should break through the "glass ceiling" of industrialization by not only agglomerating assembly and parts industries (quantitative expansion) but also enhancing technical absorption (qualitative improvement) in the future. Prof. Fujimoto's advice is basically the same as this but phrased in a more analytical language. See chapter 1 of this book, and also chapter 1 of VDF's *Improving Industrial Policy Formulation*, edited by Kenichi Ohno and Nguyen Van Thuong, and published by the Publishing House of Political Theory, 2005.

The mission raised three questions related to this view. First, can modularity-based local firms (such as Vietnam's local motorcycle assemblers) survive WTO and FTAs and become the basis of further development or will they be eliminated? Second, in light of the finding that industries in developing countries go through three stages: (i) the rise of a pioneer to start a new business; (ii) expansion of copy production with low quality and low price; and (iii) emergence of an innovator to raise quality and competitiveness33, does the transition from quantity to quality (from (ii) to (iii)) require FDI or can it be done by domestic effort only? Third, architectural evolution is private sector-driven in Japan, but does it perhaps require policy intervention in developing countries?

Whether the government and ODA can play useful roles in speeding up the upgrading process of industries was also discussed. While policy support is theoretically desirable, actual policies based on insufficient information tend to assist wrong producers (weak or politically connected producers), leading to a waste of public money. Unproductive copycats who will disappear soon and innovative imitators who will contribute to industrialization must be distinguished before assisting local producers. But such a distinction may not always be possible.

Application of business architecture theory to industrial dynamics in developing countries is a new and evolving field in the Japanese academic circle, and answers to the questions raised above cannot be given immediately. But they may provide useful insights to Vietnam's industrialization in the near future when these ideas are better organized and expressed.

[33] Tetsushi Sonobe and Keijiro Otsuka, *Roots and Strategies of Industrial Development: Lessons from the East Asian Experience*, Chisen Shokan, 2004 (in Japanese).

# (1) Thailand

## 1. JETRO Bangkok

**Venue:** JETRO Bangkok Office
**Time:** 9am, February 18, 2005

**JETRO participants:**

Mr. Atsuo Kuroda, President of JETRO Bangkok
Mr. Kunihiko Shinoda, Representative of JODC
Mr. Takashi Nakano, Managing Director of JETRO Ho Chi Minh City, Vietnam

**Presentations:**

- Toward the strengthening economic ties between Thailand and Japan, JETRO Bangkok
- West-East Corridor Comprehensive Industrial Development Program, 2004-2006, METI

**Received:**

- "The rise of China: How should Japan respond?" by A. Kuroda, Japan Echo April 2002, photocopy
- "Asian comeback: to earn, think Thailand and Vietnam not China", Nikkei Business, Apr. 19, 2004, photocopy, English and Japanese
- "White Paper on International Economy and Trade 2004, key points", METI, June 2004, photocopy

**Highlights:**

The Thai car industry is booming because foreign producers favorably reassessed Thailand's potential after the Asian crisis and trade liberalization. Their strategy shifted from import-substitution to global export.

With a long history of FDI absorption and industrialization, Thailand has created a relatively thick layer of supporting industries, especially

for supplying auto parts. However, Thailand now faces the challenge of emerging China which has advantages over Thailand in production cost, market potential, etc. To cope with this, Thailand is focusing on high-value and niche industries such as automobile and auto parts, food processing, tourism, fashion, and high value-added services.

Human resource may become a problem in developing Thai industries in the coming years. Thailand still lacks high-skilled labor force. Local capability in basic industries such as steel, mold and die casting is still at a low level.

For further development, Thailand should promote human resources, encourage hard infrastructure such as logistics and a power supply network across national boundaries, and improve soft infrastructure such as tax implementation, custom procedures and intellectual property protection.

Tariffs are still high for finished cars. Services are still protected.

## 2. Electrical and Electronics Institute (EEI)

**Venue:** EEI, Bangkok
**Time:** 2pm, February 28, 2005

**EEI participants:**

Mr. Charuek Hengrasmee, President
Mr. Somboon Hotrakool, Director of Administration
Mr. Chirapat Popuang, Director of Information and Technical Service Department

**Presentation:**

- Electronics and Electrical Industry in Thailand

**Received:**

- EEI brochure and company directory
- Some data on electronics and electrical industry (photocopy)

**About EEI:**

The Electrical and Electronics Institute, a non-profit agency under MOI, was established in July 1998 to promote product testing,

technological and product development, R&D, and training. The functions of EEI include the following:

- Encourage and support enhancement of value-added and local of parts and products
- Develop and maintain local electrical and electronics product standards consistent with international standards
- Continually encourage the export of electrical and electronic products
- Provide a central function in the collection, analysis, research and development of electrical and electronics data related to production, market, international trade agreement, etc.

**Highlights:**

The electrical and electronics industry has been developing in Thailand for more than 40 years beginning with the import substitution strategy of the 1970s. It is one of the most important sectors of Thailand in terms of export contribution, with the average annual growth of more than 20% in the past twenty years. In 2004, the export value was $33.07 billion, an increase of 20.6% over 2003 (34% of total export and 18.9% of GDP).

Electrical and electronic imports from China and Korea are on the rise and, as a result, Thai industries' domestic market share is decreasing. Thai SMEs are facing tougher competition and unemployment is feared. The industry needs reform in the areas of (i) telecommunication products; (ii) computer hardware; (iii) electronics components; (iv) electrical appliances; and (v) software products.

The industry lacks skilled workforce in both quantity and quality. It also lacks linkage among upstream (wafer production, material for PCB production, etc), midstream (parts and components such as IC, PCB, and capacitor) and downstream (electrical appliances and electronics products such as air conditioner, television and computer). The industry is weak in technology, R&D and marketing. In addition, the industry is now facing a threat from very cheap Chinese electrical and electronics products.

Main tasks of EEI are as follows:

- Policy support for electrical and electronics industry (analyze the situation of Thai electrical and electronics industry; recommend policy measures; coordinate and solve problems between the government and the private sector).
- Implement technical standards, factory quality inspection and testing center operation (a testing laboratory, testing service, technical standards consultation service). All electronics products sold in Thailand, whether domestically produced or imported, must pass quality tests.
- Research related to industrial promotion (conduct and coordinate projects by local or overseas researchers, etc).
- Industrial clustering service which supports production linkage and part procurement.
- Information and technical services center which collects, distributes and analyzes national and international information.
- Special projects such as supporting industrial clusters, "technology foresight study", a study on environmental impacts, and recommendation of measures to cope with the EU WEEE and RoHS directives.

## 3. Department of Industrial Promotion (DIP), Ministry of Industry

**Venue:** DIP, Bangkok
**Time:** 9am, March 1, 2005

**DIP participants:**

Mr. Prapat Vanapitaksa, Deputy Director General
Mr. Saneh Niyomthai, Director, Bureau of Supporting Industries evelopment
Ms. Chudatip Ritruechai, Industrial Technical Officer

**Presentation:**

- Investment opportunities in Thailand

**Highlights:**

MOI's internal structure was explained. DIP promotes SMEs and

community-based industries. DIP identifies main constraints, opportunities and concerns for the SME sector and supports the government, non-government organizations and the private sector in their efforts to promote SMEs. It has technical training centers for nationwide SME promotion. It also supports the formation of a service provider network. DIP endeavors to be a guide for both old and new entrepreneurs in turning ideas to practical applications.

In automobile, spare parts are targeted. At present, Thailand exports little and imports an increasingly large amount of parts. To correct this situation, the five-year plan contains a mold-making strategy.

In electronics, most Thai firms perform passive subcontracting. The government hopes to improve their capability to conduct R&D and create genuinely Thai products. The government assists with export and marketing, supply chain, supply-demand matching, "train-factory system" (large foreign firms teach small local firms), networking and clustering, foreign tours, tax preferences, etc.

DIP has the following ways to realize these goals.

- Work with private firms to figure out what kind of industrial support is needed.
- Through participating in government committees, take part in the joint policy making process. Implementation of master plans is evaluated frequently and measures are proposed continually.
- Provide SME training programs with the aid of the German Technology Institute as well as Japanese companies; establish testing centers and centers for R&D and technology transfer to SME.

DIP's list of targeted industries includes (i) agriculture (rice, rubber, etc); (ii) automotive industry; (iii) fashion (garment, textile, jewelry, etc); (iv) healthcare, spa, etc.; and (v) tourism.

## 4. National Economic and Social Development Board (NESDB)

**Venue:** NESDP, Bankok

**Time:** 2pm, March 1, 2005

**NESDP Participants**

Mr. Thanin Pa Em, Director, Competitiveness Department

**Presentation:**

- Thailand Competitiveness

**Received:**

- Ninth National Economic and Social Development Plan 2002-2006 (hardcopy)
- Eighth National Economic and Social Development Plan 1997-2001 (hardcopy)

**Highlights**

Mr. Thanin delivered his presentation on the competitiveness of Thailand. Industry positioning and mapping were also explained. Discussion focused on competitiveness analysis as well as industrial policy to sustain the competitiveness of Thai industries in the context of globalization.

- NESDP uses the McKinsey competitive GE methodology to build the Thai Competitiveness Matrix (TCM). NESDP then identifies the relative position of each industry. Using TCM, the main constraints, opportunities and concerns for each industry or sector are identified and ways to formulate and implement policy are figured out.
- Thai industries can be classified into six groups: new wave, opportunity, star, trouble, question, and falling star. The criteria for classification are current size and growth.
- By using TCM, the government can pinpoint each sub-sector or industry. Then, in-depth sector analysis can follow.

## 5. Thammasat University

**Venue:** Faculty of Economics, Thammasat University, Bangkok
**Time:** 9am, March 3, 2005

**Thammasat participants:**

Prof. Somsak Tambunlerchai

Prof. Thamavit Terdudomtham
Dr. Kriengkrai Techakanont

**Received:**

- "Historical development of supporting industries: a perspective from Thailand" by Kriengkrai Techakanont and Thamavit Terdudomtham, Obirin University, March 2004, photocopy

**Highlights:**

The Vietnamese delegation asked about the implementation of localization policy in the past as well as the experience of Thailand in developing supporting industries through policy measures.

- In the past, the Thai government implemented an aggressive localization policy based on the point system. Each part had weighted points and certain levels of total points (out of 100) were targeted for passenger cars and trucks. Producers were required to reach these levels or faced much higher import tariffs on parts. Although weights were often negotiated between companies and the government, it can be said that this policy promoted supporting industries especially in metal, rubber, and plastic parts. Relocation of Japanese firms to Thailand was further stimulated by the yen appreciation after the Plaza Agreement of 1985.
- If localization is pushed too hard and too ambitiously, it would create distortion and inefficiency. For example, firms would add an unneeded minor work on an imported engine to make it a "local" product. Or they will bring foreign parts makers quickly instead of fostering local partners over time. In Thailand, negotiation and bargaining between producers and the government resulted in reasonable localization targets, so all producers met localization requirements without exception.
- Thailand removed localization requirement in 2000 and shifted to a more liberal policy framework because of WTO. The Thai government helped local parts makers to reduce cost and acquire technology. It revised the import tariff structure on raw materials to lower their production cost.
- Unlike Malaysia, Thailand has no national car strategy. As a

result, all investors are treated equally. This has been a very important factor in attracting assemblers and parts makers to set up operations in Thailand.

- However, local capability and technology are still at low levels. Dependency on foreign technology and management remains high even after 40 years of industrial development. The government did not succeed in upgrading the quality of Thai supporting industries. For this, improving local capability and inducing foreign firms to procure locally must be combined. The Thai government failed in this. The government is supporting SMEs and human resource development, but they are not very effective. It should do much better in these areas.
- The automotive master plan is only a guideline with broad directions. Actual implementation is an ongoing and cooperative process among all producers and government bodies concerned.

## 6. Office of Industrial Economics (OIE), Ministry of Industry

**Venue:** OIE, Bangkok
**Time:** 2pm, March 2, 2005

**OIE participants:**

Mr. Nat Chulkaratana, Director, Dept. of Engineering Industries
Ms. Chutaporn Lambasara, Director General (at the outset only)

**Presentation:**

- Automotive Industry

**Received:**

- OIE brochure

**Highlights:**

- Thailand is one of the largest automotive countries in Asia. Thailand focuses on automotive rather than electronics and electrical industry. To become a Detroit of Asia is our goal. But this does not mean we will be like Japan or Korea, which is too difficult. Compared with automobiles, we do not think electronics has comparative advantage against China in the future.

- Thailand is promoting high value-added products through advanced technology, strengthening R&D and encouraging product design and innovation. Another goal is import substitution; we import too many things that can be produced locally, for example, farm machines. We are also strengthening supporting industries, particularly SMEs. The main promotion tool is tax and tariff policy. The Thai government does not care the nationalities of companies operating in Thailand any more. In the past, we did. MOI will soon become the Ministry of Industry and Entrepreneurs. (The mission asked if free trade initiatives and import substitution strategy conflicted, but Mr. Nat did not think so.)
- In the last four years under the Thaksin government, federal committees on steel, auto, electronics, etc. were set up. As a result, policy formulation and private sector participation have improved greatly. We now have a very active top-down government whose decision making is faster than private decisions. The prime minister orders ministries to study which products should be strengthened. Value-chain and supply-chain analyses are used for this purpose.
- Every two weeks, the private sector (by industry) meets the prime minister. If there is a complaint, Mr. Thaksin orders relevant ministries to look into the matter and correct the situation. Thailand is being run like a private company. The government is streamlining the administration by reducing personnel and raising the salary by 30%. Under these circumstances, the importance of NESDB and the five-year plan may be educed.
- Corruption in Thailand is very limited. Political lobbyists naturally exist, but otherwise policy making today is relatively clean and open.

  After the meeting, the mission wondered if top-down liberalization policy with broad supporting measures was enough to strengthen the Thai industrial base further. After intense discussion, no consensus was reached among mission members.

## 7. Board of Investment (BOI)

**Venue:** BOI, Bangkok
**Time:** 9am, March 3, 2005

**BOI participants:**

Mr. Thamrong Mahajchariyawong, Deputy Secretary General
Mr. Sakchai Luangsathikul, Senior Investment Promotion Office
Mr. Secksan Ruawohann, Director Investment Promotion Division 3

**Presentation:**

- Investment opportunities in Thailand

**Received:**

- Powerpoint file of above presentation
- "Thailand of investment. Double your expectations" (BOI information package)

**About BOI:**

BOI is a centralized organization to implement the Thai government's drive to attract FDI and provide incentives to stimulate investment. Previously, BOI was under the Office of Government and chaired by the prime minister. With the recent administrative reform, it was placed under MOI.

**Highlights:**

At first, slides containing economic data, Thailand's attraction, BOI's functions, FDI procedure, government policies, a list of incentives, international cost comparison, etc. were shown. The presentation was clear, concise and up-to-date. Discussion followed.

- BOI's list of targeted industries is as follows: (i) agro-products; (ii) fashion; (iii) automotive; (iv) electronics and ICT; (v) long-stay tourism; and (vi) energy and renewable energy (this was added last year). Each ministry and agency has slightly different targeted industries because of their policy interest and responsibility. But most targeted industries overlap.
- BOI promotes projects that: (i) strengthen industrial and technological capability; (ii) make use of domestic resources; (iii)

develop basic and supporting industries; (iv) contribute to rural regions outside Bangkok; (v) develop infrastructure; and (vi) protects environment.

- The Thaksin government gives top-down orders. Its policy is to deregulate industries and give them freedom to respond to market forces, and to provide a framework to facilitate sustainable growth. We have a liberal and transparent FDI regime where all activities are open to foreign firms without ownership or localization restrictions, except when there is an environmental concern. We are taking a large number of initiatives to further liberalize the FDI regime. We welcome all firms, not just big ones. Our incentive scheme, preferred projects and approval procedure are explained clearly in the brochure and website. The investment application form can be downloaded from the website.
- Regarding the current government, policy is formulated in the following steps. First, the government states broad strategies to the parliament. Next, it prepares Vision 2010/2020, which is followed by the four-year strategy. Then, each ministry prepares annual action plans. The four-year strategy (which includes concrete fiscal arrangement) is different from the five-year plan (which remains indicative and concerned with social aspects). The five-year plan is still needed for social concern and ensuring consistency among policies. We now have better inter-ministerial coordination. Previously, each ministry worked by itself and did not talk with others. They still do not talk to each other but Mr. Thaksin's vision integrates them at the top. But at the operational level, we are still in the process of learning. We need to sort out which concrete policy belongs to which ministry.
- Our FDI target is 270 billion baht in 2005, but we may exceed this and achieve 300 billion baht. Before, we targeted “net applications” (submitted less returned documents) but we now focus on “actual certificates”. The latter requires more documents and reflects investors' seriousness more accurately. Our maximum approval time is 60 working days for small projects (less than 500 million baht) and 90 working days for larger projects. We are actually faster than this, and trying to shorten the maximum periods further.

- Our FDI policy is changing every five years but always for better. We have centralized general incentives and promotion. We do not have case-by-case treatment. Unlike Vietnam, all FDI applications are processed by BOI. Local governments have no authority to approve them regardless of investment size. They are not permitted to offer additional incentives. If local governments are given free hand in offering incentives, there will be too much competition and too generous packages. But if provincial leaders have good visions, they can use national promotion measures to attract FDI.
- Technical transfer measures are tricky because investors become angry if you regulate them too much. We implement only broad measures to encourage technical absorption. Localization is no longer forced. Technical barriers were also abolished. We just open up and let the market decide.
- The greatest attractiveness of Thailand is its welcoming attitude toward FDI. "Red carpet treatment" for investors should always be maintained in the future.

## 8. Thailand Development Research Institute (TDRI)

**Venue:** TDRI, Bangkok
**Time:** 2pm, March 3, 2005

**TDRI participant:**

Somkiat Tangkitvanich, PhD, Research Director

**Received:**

- TDRI brochure and publication list

**Highlights:**

- It is obvious that the Thaksin government has clear visions for industrial policy, but visions and implementation are two different matters. This is the most interventionist government in the history of Thailand. They are trying to promote certain industries by creating industry-specific institutes. It is not certain whether they are effective. Subsidized institutes are often inefficient and may crowd out private activities. The current government is a PR (public relation) government, with very good

publicity and popular support, but action is more difficult than PR.

- Sometimes, policies tend to favor some special interest groups. Corruption is serious and intensifying under the current government. As a result, the government sometimes launches conflicting programs. But it is not effective to promote a large number of industries with limited resources.
- Tariff reform is slow, but this has been true for a long time. The service sector is still highly protected. Telecommunication and banking remain closed to foreign investors.
- I do not know about new government committees for individual industries, but if they are promoting private-public dialogue, it is a good thing.

## 9. Thailand Automotive Institute (TAI)

**Venue:** TAI Bangkok office, Bureau of Supporting Industries, Bangkok
**Time:** 9am, March 4, 2005

**TAI Participant:** Mr. Vallop Tiasiri, President

**Received:**

- Master plan for Thai automotive industry 2002-2006 (Thai original hardcopy)
- Master plan executive summary (English and Thai hardcopy)

**About TAI:**
TAI was established in 1999 as an autonomous non-profit organization. It has 70 staffs of which 30 are engineers. It is financed by both the government and the private sector in order to develop the automotive industry (automobiles, motorcycles and their parts) and strengthen the competitiveness of Thai products. TAI cooperates with researchers from ten universities in Thailand, MOI, the Ministry of Commerce, MOF, and the Ministry of Science and Technology. TAI provides research and information services and manages a website for automotive part makers (www.aseanautoparts.info) which is updated by producers. This is an APEC supported website.

**Highlights:**

- TAI has three main activities: (i) policy study and advice; (ii)

supporting the clustering of auto parts; and (iii) export promotion. "Cluster" is not just networking but working together. We are trying to change the mindset of local producers and induce them to cooperate. Cluster members can be local, JV or 100% foreign. Toyota and Denso are asked to help SMEs.

- Our training center is open for any firm (but we teach in Thai). Thai workers are good at skills but without knowledge. We have trained 40,000 workers from 525 firms. But we need to upgrade the evaluation system after the training. Thai workers are afraid of competence exams. We also operate testing centers. Testing equipment is too expensive for individual SMEs so we offer this service for all.
- The automotive master plan is drafted by TAI (hardcopy received). The current one (2002-2006) has the following chapters: (i) global situation; (ii) Thai situation; (iii) SWOT analysis; (iv) strategy and targets for the next five years; (v) action plans. The targets for 2006 (1 million cars, 40% exported; 2 million motorcycles, 20% exported; parts export of 200 billion baht; 60% localization) are likely to be achieved within this year. Our forecast for 2005 is 1.1 million cars (420,000 exported) and 3 million motorcycles (800,000 exported), and parts export worth 220 billion baht. The contents of action plans are decided by producers. TAI only coordinates and summarizes them.
- It normally takes about one year to complete a master plan. It is truly a joint product between private firms and MOI, with TAI assistance. The drafting is done by TAI. The master plan is submitted to MOI who is its official author. MOI then sends it to the government and eventually to the prime minister. Besides this official channel, TAI also sends the draft to the private sector and lets it directly present to the prime minister. The prime minister will hear the same master plan from both sides, but presentation by the private sector is more convincing. In Thailand, there is no official approval of the master plan. It is implemented as a consensus of all parties. The important thing is that this plan be included in the national five-year plan which secures its funding. We are now trying to draft a new master plan. The methodology will be the same but we will have new targets.

- The agreed master plan contains broad numerical targets as listed above. As long as these targets and ideas behind them are valid, there is no need to revise them. Indeed, the current master plan has not been revised. In implementation, remaining questions are "details" (concrete projects) and "how much" (budgeting) which are decided and adjusted continuously. Technical assistance through ODA or foreign firms is often mobilized. Here too, private-government communication is very close. There is no need for confrontation. I meet with producers at least twice a month formally. Besides that, I have many informal meetings with them. We are a small institute but we participate actively in many steering committees.
- Private companies will not transfer technology until it is profitable for them and the receiving side of technology is ready. We have no nationality preference. Any investor from any country is warmly welcome. While foreign companies are strong here, Thailand is not dominated by them. The government makes a fair and balanced compromise between national goals and foreign companies' demands.

## 10. DENSO

**Venue:** Head Office of Denso Thailand Company, Samutprakarn
**Time:** 9:30am, March 4, 2005

**Denso participants:**

Mr. Montree Musitmanee, General Manager of Engineering Section
Mr. Thavorn Chalassathien, Director, Administration & Denso Training Academy Others

**Presentation:**

- Investment opportunities in Thailand

**Received:**

- Denso information package

**About Denso:**

Denso Thailand was established in 1972 with a capital of 200 million baht. It has a workforce of 3,163, of which 28 are Japanese. It produces

cooling systems, electrical products, starters, radiators, magnets, wiper motors, alternators and spark plugs, for automobiles and motorcycles. Its main customers are Toyota (50%), Isuzu, Honda, Mitsubishi, and Hino. It also exchanges parts among other Denso factories in Asia.

**Highlights:**

The Vietnamese mission asked about investment environment, the role of government in formulating policy, capability of Thai supporting industries and the strategy of Denso in the future if a new government changes industrial policy.

- Denso highly appreciates the investment environment of Thailand with thick supporting industries and appropriate policy and incentives. In fact, few foreign companies complain about Thai industrial policy and investment environment. Most investors are hoping to have long-term commitment in Thailand, especially in the automotive industry, because of predictable industrial policy and a strong network of supporting industries. While industrial policy is revised and adjusted frequently, the private sector is happy because it can get involved in drafting, implementing and revising industrial policy. The Thai government is now focusing on improving human resources by establishing technical training centers.
- Denso's high quality is the reason why major customers come to purchase our parts. Since our reputation is well established, we have only a small budget for marketing and public relation. Denso believes that the Thai government will not change its policy of promoting the automobile industry. Therefore, Denso keeps investing in Thailand in the coming years.
- Denso uses the "keiretsu" system in doing business in Thailand. We work only with long-term Japanese partners. Human resources in Thailand are quite weak. There is a shortage of highly skilled workers and technicians but the situation is improving gradually.

## 11. Thai Summit Group (TSG)

**Venue :** Head Office of Thai Summit Auto Parts Industry, Samuthprakarn

**Time:** 2:30pm, March 4, 2005

**TSG participants:**

Mr. Cheevit Limsiri, Chief Engineer, R&D Unit
Mr. Panikai Aroonchitt, Laision & Projects Manager, Executive Vice President's Office
Mr.Chatkaew Hart Rawung, Manager, Automotive Parts Department

**Received:**

- TSG information package

**About TSG:**

Established in 1977, this local company group now has five overseas plants in India, Indonesia and Malaysia, and one branch office in Yokohama. The workforce is approximately 13,000 and its main products are automobile and motorcycle parts, and electrical parts for home appliances and agricultural machine. Its main customers include Toyota, Mazda, Honda, Yamaha, Samsung and Tiger. It recently established an R&D Department with 41 employees to undertake parts design. The group has four training rooms for its employees. The group also has 22 joint venture units with Japanese companies.

**Highlights:**

There was a factory tour at first. TSG factories here had a large number of stamping, welding, metal-working and other machines, most of which were made in China. A large structure housed a motorcycle parts factory and an auto parts factory with a warehouse in between. Most products were metal and plastic. There was also a showroom.

- TSG is one of the three biggest local (Thai) suppliers of auto and motorcycle parts in Thailand. TSG follows TSCIC principle (Teamwork, Social responsibility, Continuous improvement, Initiatives and leadership, Commitment).
- TSG established the R&D Department three years ago and is internalizing parts design capability. It has designed a golf cart. Currently, TSG is trying to design a three-wheeled car for the Asian market. Technical training programs supported by Japanese experts are organized frequently. TSG also sends staff to

Japan to absorb technology and skills from Japanese companies but it is still a difficult task.

- TSG is quite confident with its competitiveness against other domestic companies. Their main competitors are foreign and FDI firms. Raw materials are mostly imported from Japan since Thai raw materials are low quality.
- To improve the ability of managers, a job rotation program for all prospective managers is implemented.
- There is no complaint about tax and tariff policy of the Thaksin government. In addition, TSG joins the Thai Chamber of Commerce to raise a voice on government industrial policy.

# (2) Malaysia

## 1. JETRO Kuala Lumpur

**Venue:** JETRO Kuala Lumpur
**Time:** 9:30 am, January 9, 2006

**JETRO Kuala Lumpur participants:**
Mr. Tsuneo Tanaka, Managing Director
Ms. Ayako Hashimoto, Director

**Presentations:**
Overview of Malaysia Economic Development (verbal)
Malaysian Economy, JETRO Kuala Lumpur (slides)

**Highlights:**
Malaysia, generally regarded as one of the most successful non-western countries, has achieved a relatively smooth modern economic growth over the last century. Malaysia has experienced rapid industrialization in the past thirty years, transforming itself from an economy dependent on mineral and agricultural products into one dominated by manufacturing and services. The electronics and electrical (E&E) industry is the largest sector, followed by chemicals and chemical products, and scientific and measuring equipment. The country is now categorized as an "upper middle-income country" by the World Bank, with a per capita income of about $4,800 in 2004. It is the third richest country in ASEAN after Singapore and Brunei. Over the last three decades, Malaysia's economic policy has undergone three stages:

*1957-1969: rural development and import substitution*. During this period, the Malaysian government directed resources for the benefit of rural Malay communities, such as village schools, rural roads, clinics and irrigation projects. In addition, the government was keen to reduce dependence on commodity exports, which put the country at the mercy of fluctuating international prices. Several agencies were set up to enable Malay small-holders to upgrade their production and increase

their income. The government also provided a range of incentives and low-interest loans to help Malays start businesses. Since official procurement favored Malay companies, many Chinese-owned businesses were obliged to "Malayanize" their management. All this tended to reduce the gap between the Chinese and Malay standards of living, although some argue that this would have happened anyway as a result of Malaysia's general prosperity under increased international trade.

*1970-1990: industrialization and the New Economic Policy*. The formulation of the New Economic Policy (NEP) in 1970 was a response to the deadly riots in 1969 against the economically dominant ethnic Chinese. The government's commitment to the free market was now hedged by its Bumiputra policies aimed at providing “constructive protection” of Islamic Malays against domestic economic competition from other ethnic groups and foreign investors. NEP was intended to reduce poverty and the economic gap among ethnic groups, but it also created a Malay rentier class which relied on political patronage.

NEP tried to restructure the Malaysian economy over the two decades, from 1970 to 1990, with the following aims:

- Redistribution of corporate equity so that the Bumiputra's share would rise and the dominance of the Chinese Malays would decline. With respect to employment, the Bumiputra's share in each sector was aimed to rise to reflect more accurately the ethnic distribution of the population.
- Preservation of national unity through the amendment of the Constitution to forbid discussion, even in Parliament, of certain “sensitive issues”, including the special position of the Malays and Borneo's ethnic groups. The amendment also required all government bodies to use Bahasa Malaysia as the principal official language. Many non-Malays resented this approach.
- Improvement of economic conditions of the Malays.
- Eradication of poverty irrespective of race. The government implemented a large number of programs for rural development during this period.

*1990s and the new millennium: the National Development Policy*. NDP, initiated in 1991, re-focused on wealth creation and de-emphasized Malay preferences. This did much to ameliorate racial tension. At the same time, the government announced "Vision 2020", a goal aimed at making Malaysia a fully developed nation with a high standard of living by 2020. Malaysia suffered from the regional economic crisis in 1997-98. While growth was sharply negative in 1998, Malaysia was able to take measures which put its economy back on track.

In the view of JETRO Kuala Lumpur, the success of Malaysia is based on political stability and peaceful power transition, rich natural resources such as wood, rubber and oil, charismatic leadership especially of Dr. Mahathir, and policy transparency. The business environment in Malaysia is better than many other neighboring countries. Corruption is also modest. However, with the emergence of China, Malaysia is now facing reduced FDI inflows as MNCs shift their production to China where labor is much cheaper. Unlike the past, large FDI projects are unlikely to come to Malaysia in the future. But there is still room to attract FDI in telecommunication, ICT, chemicals, bio-technology, and other high-tech areas. Malaysia should be able to sustain an average growth rate of 4-5% per year.

The protection of automobiles will be phased out within the AFTA framework in the next few years. The government seems to have abandoned the idea of total protection of Proton. This national car company still enjoys a large domestic market share but faces fierce competition from big foreign names. In promoting industrial development, SMIDEC plays an important role in fostering SMEs, especially Malay SMEs. In addition, the SME Act was launched in 2005 to accelerate SME development.

## 2. Malaysian Industrial Development Authority (MIDA)

**Venue:** MIDA, Kuala Lumpur
**Time:** 2 pm, January 9, 2006

**MIDA participants:**
Mr. Arham Abdul Rahman, Deputy Director, Domestic Investment Promotion Division
Mr. Roswaidin Mohd Zain, Assistant Director, Domestic Investment Promotion Division

**Presentation:**
MIDA's functions in the promotion of the manufacturing and services sectors

**Received:**
MIDA brochure, and information about industrial promotion in Malaysia

**About MIDA:**
Established in 1967 under the Act of Parliament, MIDA is the principal agency for promoting and coordinating industrial development. It is the first point of contact for investors who intend to set up manufacturing and manufacturing related services operation in Malaysia.

Headquartered in Kuala Lumpur, MIDA has a network of 16 overseas offices covering North America, Europe and Asia-Pacific, to service potential overseas investors. Within Malaysia, MIDA has 10 branch offices to assist investors in the implementation of their projects. The major functions of MIDA are:

- To promote foreign and local investments in the manufacturing and manufacturing related services sectors.
- To undertake planning for industrial development.
- To recommend policies and strategies to the Ministry of International Trade and Industry (MITI).
- To evaluate applications for manufacturing licenses and expatriate posts; tax incentives for manufacturing activities, tourism, R&D, training institutions and software development; and duty exemption on materials, components and machinery.
- To assist companies in the implementation and operation of their projects, and offer assistance through direct consultation and cooperation with relevant authorities at both the federal and state levels.

**Highlights:**

MIDA is one of the five agencies under MITI and plays a role similar to the Board of Investment in Thailand. MIDA's scope of authority, namely promoting manufacturing investment and approving projects, is clear and there is no overlapping with the mandates of other agencies. Senior representatives from related agencies are stationed at the MIDA headquarters in Kuala Lumpur to advise investors on policies and procedures. They are from the Ministry of Finance, Ministry of Human Resources, Immigration Department, Royal Customs Malaysia, Department of Environment, Department of Occupational Safety and Health, Tenaga Nasional Berhad, and Telekom Malaysia Berhad. MIDA conducts weekly meetings to approve projects with the attendance of these representatives. MIDA also organizes monthly meetings with chambers of commerce and businesses to exchange information. In addition, MIDA assigns about twelve officers to follow up approved projects in all states.

As Malaysia now faces a shortage of labor, it wishes to switch from labor-intensive operation to high-tech industries. To attract such FDI, special incentives and customized packages are given to targeted individual foreign firms through negotiation on a case-by-case basis. Tax incentives are provided only by the federal government, but local authorities can offer other incentives in the form of favorable land and water conditions.

From the viewpoint of MIDA, key success factors in FDI attraction to Malaysia are political stability, the business-oriented government where policies are formulated openly by private initiative, and good infrastructure including an excellent highway network and modern airports and seaports.

While Malaysia continues to promote FDI, it also encourages domestic investments to ensure that Malaysian entrepreneurs actively participate in industrial development. Policies and measures have been put into place to sustain Malaysia's competitiveness and maintain the country as an attractive location for investors. These include:

- *Liberalization of investment policy*. Foreigners are now allowed

to hold up to 100% equity in manufacturing projects and manufacturing related service activities.

- *Enhancement of the administrative system*. The approval process of manufacturing licenses has been streamlined over the years by removing unnecessary and cumbersome procedures and regulations.
- *FDI promotion into high value-added sectors*. High-tech and knowledge-intensive projects in the manufacturing sector, such as ICT, bio-technology, optics, photonics, nano-technology, medical devices, and advanced materials are encouraged.
- *Promotion of the services sector*.
- *Provision of focused and competitive incentives*.

## 3. Economic Planning Unit, Prime Minister's Department

**Venue:** Industry and Economic Services Section, Economic Planning Unit, Putrajaya
**Time:** 9:30 am, January 11, 2006

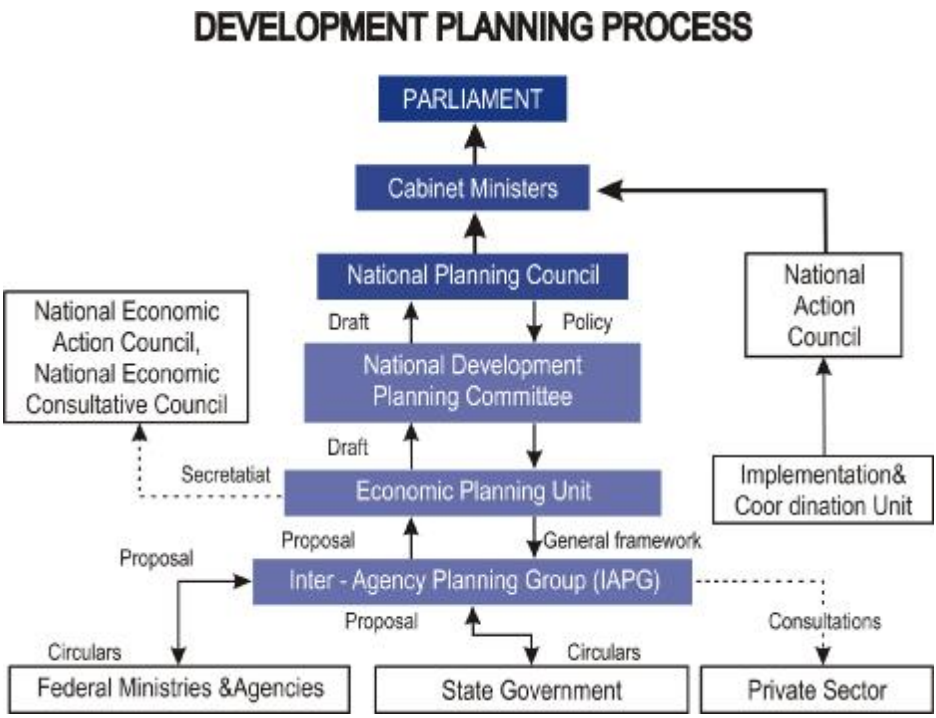
**EPU participants:**

Ms. Layla Wathiqah Judin, Principal Assistant Director, Industry and Economic Services Section
Mr. Nirwan Noh, Principal Assistant Director, Industry and Economic Services Section
Mr. Asdirhyme Abdul Rasib, Principal Assistant Director, Industry and Economic Services Section

**Presentation:**
Industrial Policy: Malaysia's Experience

**About EPU:**
The Economic Planning Unit, in the Prime Minister's Department, is the central planning agency responsible for formulating policies and strategies for economic development with the overriding objective of achieving national unity. The planning cluster is composed of EPU and other central agencies, while the implementation cluster involves the Implementation Coordination Unit and the relevant staff agencies. Planning in Malaysia is a two-way interactive process between EPU on

the one hand and line ministries and agencies on the other, as shown in the diagram below. This top-down and bottom-up process ensures that policies and strategies are mutually consistent and that development concerns at sub-regional levels are fully integrated into overall national development thrusts.




Source: EPU's website.

**Highlights:**

Key policy documents include Vision 2020 (1991-2020), which sets the main objective in the long run, Outline Perspective Plans (OPPs), five-year plans (currently the 9th Malaysia Plan is under preparation), and annual budgets. Malaysia Plans are produced by EPU while Industrial Master Plans are compiled by MITI.

OPP covers overall growth of the economy and includes indicators such as GDP, inter-sectoral linkages, sectoral contributions, employment projections, redistribution of economic gains, and social

development. Five year plans are investment plans for realizing the objectives of OPP. Annual Operating Plans are actual physical and financial plans for implementing the five-year lans.

IMP2 (1996-2005) focused on cluster-based industrial development and manufacturing plus plus orientation. The latter was intended to move Malaysia along the value chain horizontally towards higher value activities as well as shift the whole value chain curve upwards through productivity-driven growth. Industries to be developed under this approach included electrical and electronics, textile and apparel, chemicals, resource-based industries, agro-based and food product industries, materials and advanced materials, transportation, and machinery and equipment.

IMP3 (2006-2020) will focus on services and establishing linkage among clusters. Although IMP2 has not been reviewed, IMP3 will be reviewed every five years. The Malaysian government places emphasis on project monitoring to ensure that policy implementation is in tandem with the objectives as well as strategies set by the National Development Policy and the five-year plan. This enables the government to identify and remedy any failure or delay in the implementation of any program or project, thus saving costs.

For IMP2, a researcher at the Malaysian Institute of Economic Research (MIER) produced initial ideas. No such analytical input was made for IMP3.

The mission asked if IMP2 lacked selectivity since the eight listed clusters covered virtually all key industries of Malaysia. It noted that spreading public resources thinly across many industries was considered a problem in Vietnam. EPU replied that, since the clusters were private sector-driven, large public investment was not needed and broad orientation posed no budget problem.

EPU emphasized that there was no shortcut to progress and development. The mission asked to clarify this statement since Vietnam often sought shortcuts in industrialization. EPU explained that, in multi-racial society, policy must be devised with care, and laissez-faire growth without social concern was unacceptable.

Regarding Vision 2020, there are nine stated challenges such as national unity, mature democratic society, ethical society, and prosperous society. Vision 2020 includes only qualitative statements without numerical targets. To achieve this Vision, policy documents mentioned above map out concrete targets and make necessary adjustments during the implementation period.

## 4. Ministry of International Trade and Industry (MITI)

**Venue:** MITI, Kuala Lumpur
**Time:** 2 pm, January 11, 2006

**MITI participants:**
Mr. Wan Zakaria Wan Ibrahim, Principal Assistant Director, Strategic Planning Division
Mr. Davidson Dee Ladi, Assistant Director, Strategic Planning Division

**Highlights:**
Malaysia implemented IMP1 (1986-1995) to lay the foundation of the manufacturing sector. IMP2 (1996-2005) aimed to develop cluster-based industrial development and manufacturing plus plus orientation. Its investment target was surpassed. IMP3 (2006-2020), currently being prepared, will continue to make Malaysia more competitive in the global market and transform it into a fully advanced country. While IMP3 will boost existing industrial clusters, new elements such as services, selected subsectors, networking, and cross-border investments will be added. Efforts will be made to accelerate a shift toward higher-end activities and products, and to strengthen linkages among clusters and with the global economy. The draft of IMP3 is almost finished, but it is waiting for the finalization of the latest data.

The drafting process of IMP3 was explained. Overall policy orientation was decided by the Industrial Planning Committee (IPC) chaired by the Minister of MITI. There was no single person or report that decided the policy direction as it was a result of evolving ideas through many meetings. After this, the Steering Committee (SC) was organized to draft the plan. It in turn called for Technical Resource Groups (TRGs) to prepare assigned chapters. Under the broad directive, the way to draft each chapter was largely left to each TRG. Usually a writer was

appointed, who might be an official, an academic or a business person. First drafts were submitted to the MITI secretariat and reviewed by businesses and MITI officials. No foreign experts were mobilized at the IPC or SC level.

The time sequence of drafting was explained in detail. Private sector involvement was intense through participation in TRGs, first brainstorming, etc. The whole process was rather complicated but it was properly carried out thanks to frequent contacts among concerned ministries and agencies as well as with the private sector. Any inter-ministerial conflicts could be resolved during TRG sessions. IMP3 only sets out broad measures such as tax incentives. Details will be decided later by MIDA or any other relevant organizations.

Ten TRGs were organized, including macro-framework, external trade, investments, development of SMEs, human resource development, ICT and enabling technologies, marketing/branding, logistics, sectoral development, and services. These TRGs correspond to proposed chapters.

The mission noted that IMP2 was a bold and unique document strongly guided by academic concepts such as value chain and industrial clusters. MITI officials thought that IMP2 was implemented satisfactorily. Investment achieved its objective and exports also increased.

The Vietnamese side also felt that projecting 15 years would be difficult in a fast-changing world and for dynamic industries like E&E. MITI replied that IMPs and other plans were instruments to realize the 2020 Vision. They were rolling plans and IMP3 would be reviewed every five years. Concrete implementation and monitoring mechanisms for IMP3 are still under consideration. No details will be in IMPs as actual implementation is at the level of relevant committees, ministries and agencies.

## 5. Small and Medium Industries Development Corporation (SMIDEC)

**Venue:** SMIDEC, Selangor Darul Ehsan

**Time:** 9:30 am, January 12, 2006

**SMIDEC participants:**
Ms. Norsalehah Nasir, Director, Strategic Planning Division
Ms. Saraya Kulop Abdul Rahman, Senior Manager, Strategic Planning Division
Two other ladies

**Presentation:** Presentation on SMIDEC

**About SMIDEC:**
SMIDEC was established in 1996 in recognition of the need for a specialized agency to promote small and medium enterprises. SMIDEC's functions are:

- To formulate policy and implement programs for the development of SMEs
- To provide technical and advisory support services in collaboration with other related agencies for SME development
- To forge industrial linkage between SMEs and large companies or MNCs
- To implement, coordinate and monitor financial assistance schemes for SMEs
- To collaborate with other local and international SME-related agencies

**Highlights:**
As of 2003, the total number of manufacturing SMEs in Malaysia was 18,271. SMEs play an increasingly important role in job creation and economic growth of Malaysia. SMIDEC is a facilitator of SME development with a budget for grants and soft loans of about RM700 million ($190 million). SMIDEC helps Malaysian companies to be globally competitive.

To be eligible for SMIDEC's financial assistance, companies must have at least 60% Malaysian equity in the manufacturing and manufacturing related services and agro-based industries, with an annual turnover not exceeding RM25 million or fulltime employees not exceeding 150. For companies in the services and information and communication technology sectors, qualification requires an annual turnover not exceeding RM5 million or fulltime employees not exceeding 50.

Grants may be provided to assist SMEs in business planning and development, product and process improvement, productivity and quality improvement, and certification; market development; development and promotion of halal products (food prepared according to the Islamic principle); and enhancing product packaging, design and labeling capabilities. Soft loans are provided for factory relocation, ICT adoption, etc. Grant application is processed within 14 working days and disbursement within 20 working days.

Regarding the Industrial Linkage Program (ILP), SMIDEC maintains a database of about 18,000 companies and has organized annual match-making events participated by more than 250 local suppliers and MNCs. ILP is also enhanced by SMIDEC's existing support programs such as grants, soft loans and development programs. SMEs that propose to manufacture promoted products or conduct promoted activities in ILP are eligible for pioneer status with 100% exemption on statutory income tax for five years, or 60% investment tax allowance on qualifying capital expenditure incurred within five years with 100% exemption on statutory income tax. For MNCs or large companies that participate in ILP, expenditure incurred in the training of employees, product development, and testing and factory auditing to ensure the quality of vendors' products, can be deducted in computing income tax.

In addition, there is the National SME Development Council chaired by the Prime Minister and attended by the ministers and heads of 18 key organizations involved in SME development. This council coordinates SME development programs. SMIDEC is an active member and a coordinating agency of this council.

SMIDEC has contributed to IMP3 by drafting the chapter on SME development. For this purpose, it has organized a series of meetings with other ministries and organizations to gather inputs to chart future direction and strategies. The National SME Development Council hired experts, and selected one of them as the editor for the entire chapter. SMIDEC staff worked very hard to draft the SME chapter. In the process, some difficulties were encountered due to time constraint and the quality of SME statistics.

## 6. Proton

**Venue:** Proton Holdings Berhad, Selangor Darul Ehsan
**Time:** 2 pm, January 12, 2006

**Proton participant:** Mr. Haris Fadzilah Hassan, Head, Corporate Planning Division

**Presentation:** Overview on the manufacturing sector, the automobile industry, and Proton

**About Proton:**
The national car project, Perusahaan Automobil Nasional (Proton), was incorporated in 1983 and plant operation started in 1985. Initially, its shareholders were Khazanah Nasional (38.32%), Employees Provident Fund (12.04%), Petronas (7.85%), and other local and foreign investors (41.79%). Production began with the Proton Saga model. Propelled by the idea of creating a Malaysian car by the Former Prime Minister Dr. Mahathir, this project was conceived to create an automotive industry in increasingly high levels of technology and internal intellectual property. It enjoys preferential tax and duty rates, operates integrated production facilities, promotes industrial linkage, and carries a national brand.

**Highlights:**
Mr. Haris presented slides containing the steps in Malaysia's industrialization, its automobile industry, Proton as a national car project, and its successes and current situation. The presentation was clear, concise and up-to-date.

According to Mr. Haris, it may be difficult to objectively evaluate the degree of success of the Proton National Car Project, but it can surely be said that Malaysia took a different approach to the automotive industry from the neighboring countries. Internal development of technology and engineering know-how was not high priority in other ASEAN countries. In contrast, Malaysia's Second Industrial Master Plan (IMP2), 1996-2005, targeted the automobile industry as a vital sector. The government wanted it to adopt global orientation, enhance

capacity, add value, create brand-name recognition, and improve human resources and management.

The national car project has boosted the development of part and component production through vendor support programs. Introduction of the modular system encouraged production of sub-components. Currently, there are 4,865 parts and components produced locally, and 286 suppliers in Malaysia producing parts and components for Proton. Many key engine parts are locally produced in Malaysia while other ASEAN countries have only focused on basic casting, machining, stamping, and final assembly. All design and engineering, embodying core technology, are done outside ASEAN except in Malaysia where Proton internalizes a full range of R&D capability and facilities. Malaysia is proud to be one of the eleven countries in the world that can design and manufacture a vehicle from ground up. The Proton Group in cooperation with Lotus, a British car maker, has increased its engineering capabilities. Jobs directly created by Proton rose from 5,400 in 1996 to 10,000 currently, of which 20 % are non-Malaysians. In addition, Proton has created more than 100,000 jobs through the value chain and fostered many entrepreneurs and SMEs in Malaysia.

However, Proton is now facing a big challenge under trade liberalization and globalization. Proton's disadvantages come partly from the lack of scale economy and partly from the lack of international brand recognition. Domestic sales in 2004 were about 500,000 units in 2004 and are expected to reach 519,000 units in 2005. However, rising income and external opening are strengthening the sales of foreign-brand cars, especially those of Japan and Korea.

After more than 20 years of development, the Malaysian national automobile industry is not yet internationally competitive. Proton is difficult to survive without building a strategic alliance with a strong brand-name foreign car maker. Proton now should find such a partner and re-focus its products on niche markets in ASEAN and other regional markets.

After the meeting, the mission visited the factory which was adjacent to the office building.

## 7. Malaysian Institute of Economic Research (MIER)

**Venue:** MIER, Kuala Lumpur
**Time:** 9:30 am, January 13, 2006

**MIER participants:**
Mr. Kevin Chew, Research Fellow (macro area)
Mr. Shankaran Nambiar, Research Fellow (policy area)

**About MIER:**
The Malaysian Institute of Economic Research, a thinktank established by the government in 1985, is a non-profit organization that works with the government. It both supports and criticizes the government. There are 20 staff, of which 8 are researchers. MIER is organized into four areas: macro, "special" (trade), industry, and policy. The last covers various topics related to growth, such as competition, poverty, agriculture and industries. Annual budget proposals are also drafted by MIER.

**Highlights:**
In the process of preparing IMP3, MIER is in charge of the TRG on the macro framework. Some difficulties were encountered in drafting the chapter. The terms of reference for their work were revised after the work was begun. There was also some difficulty in collecting data. The drafting team considered the "within group" inequality (income gaps within Bumiputra) to be an important issue, but this could not be analyzed without relevant data.

Previously, when IMP2 was drafted, MIER prepared background papers before the government started drafting. But IMP3 is being prepared differently, with outside groups writing chapters without much instruction from the center. This may carry the risk of losing focus and clarity of the message. MITI could have exercised more control over the scope of issues. In addition, IMP3's longer time perspective of 15 years may cause difficulties since long-term projection is generally difficult. To achieve the 2020 goal, Malaysia needs to sustain 7% growth but this looks infeasible due to China's emergence, possible regional crises, and natural slowdown due to economic maturity.

While the mid-term reviews of five-year plans are done, there is no systematic review of IMP2. Its growth target was not met, but this was clearly due to external causes (Asian crisis). Industrial clusters did not seem to have formed as expected. The concept of industrial clusters was sound, but policy implementation was weak. IMP2 also targeted industries in which Malaysia had no comparative advantage such as advanced materials or automobiles.

The central problem of Malaysia is inability to level up internal value. Malaysia should open up more decisively, and avoid changing policies frequently. The procedure for receiving SME credit is still cumbersome. Malaysia has so far been lucky with ample natural resources, but the way ahead is not so easy.

The lack of value creation comes from weaknesses in the education system. Bumiputra orientation has created quantity-orientation, which lowered quality. Important educational resources are now fleeing to Singapore. Malaysia looks better from outside, but viewed from inside, inefficiency, corruption, and non-transparency in government procurement exist. But the scope of official discretion is narrowing under globalization.

## 8. KPMG Business Advisory Sdn Bhd

**Venue:** Wisma KPMG, Kuala Lumpur
**Time:** 2:30 pm, January 13, 2006

**KPMG participants:**
Mr. Y. K. Chin, Partner
Mr. Mohd Arif Ibrahim, Director, Advisory, Risk Advisory and Internal Audit Services
Ms. Nik Fadzrina Nik Hussain, Senior Associate, Advisory

**Presentation:** Industrial Development in Malaysia (slides)

**About KPMG:**
KPMG is one of the world's leading providers of audit, tax and advisory services.

**Highlights:**
Mr. Chin is a co-writer of the chapter on marketing and branding in IMP3. He explained the evolution and achievements of IMP1 to IMP3 as requested in advance by the mission. Slides were very clear and informative.

The Malaysian manufacturing sector took off in the early 1970s when semi-conductor giants such as Motorola and National Semiconductor came to Penang to start labor-intensive component production with cheap labor. The Industrial Coordination Act played an important role during this period.

Subsequently, IMP1 (1986-95) promoted resource-based industries. Its main objectives were (i) manufacturing acceleration; (ii) processing of domestic natural resources; and (iii) indigenous technology. Its targets were over-achieved.

IMP2 (1996-2005) highlighted manufacturing plus plus and cluster-based industrial development. However, as FDI inflow surged, complacency was created and internal capability was not generated. Meanwhile, Malaysia became the world's largest exporter of air conditioners, color TVs, and semi-conductors. Growth record under IMP2 was lower than targeted. Mr. Chin thought that IMP2's cluster strategy attained “very limited success”. He believed that the shortcomings of IMP2 would be corrected in IMP3.

The drafting mechanism of IMP2 and IMP3 were explained. IMP2 was never revised, and while its growth target was reviewed, the situations of clusters and manufacturing plus plus have not been reviewed.

A business CEO chairs, and MATRADE provides secretariat functions, at the TRG on marketing and branding, in which Mr. Chin participates as a joint writer. TRG meetings were held every 2-3 weeks. There were about 20 members but not all of them always attended. Main problems in drafting were analytical, and involved (i) understanding of the comparative advantages of neighboring countries; and (ii) measurement of brand values. For the first, TRG requested MATRADE to provide funds for a study, which was granted. For the second, there is data by Interbrand, a private company, but its measurement is

excessively US-focused. His chapter will not include any numerical targets. So far, he has not received any financial compensation for his task, but the government says he will.

According to Mr. Chin, Malaysia should find its unique comparative advantage rather than compete directly with the two giants, namely China and India. Malaysia must be complementary to them. Furthermore, Malaysia should become a hub among China, India and Indonesia, since it incorporates their ethnicities in one and practices mild Islam.

## 9. Penang Skills Development Centre (PSDC)

**Venue:** PSDC Penang
**Time:** 9:30 am, January 13, 2006

**PSDC participant:**
Dr. Ng Chern Hsoon, General Manager, Education and SME Development

**Received:** PSDC brochure

**About PSDC:**
The Penang Skills Development Centre is a unique joint effort of government, academia and industry. Although it was established by the state (local) government through the Penang Development Corporation and aided by academia, management and administration are left to the industry's discretion. PSDC accepts members from the manufacturing industry. Its tremendous success since 1989 has largely been due to the vitality of its corporate members who rank among the world's most admired corporations. PSDC operates as a non-profit society and has a current membership of 113 companies employing more than 100,000 workers. The functions of PSDC are:

- To provide cost effective training and educational programs for current and future workorce.
- To forge strategic partnership with local and foreign universities, training institutions and organizations to provide relevant programs and training interventions to enhance workforce competitiveness.

- To support the Human Resource Development (HRD) initiatives of both the federal and state government.
- To promote the development of local SMEs to be global suppliers and service providers.
- To share PSDC's intellectual property, competencies and expertise beyond Penang and Malaysia.
- To develop PSDC's own training programs and courses.
- To generate sufficient income to sustain PSDC operation and support Malaysia's human capacity building process.

**Highlights:**
According to Dr. Ng Chern Hsoon, the main success factors of PSDC were three.

First, a pro-business government with strong initiative to work with the industry in human resource development. The Malaysian government set up the HRD Fund, which collects mandatory contribution of 1% of the payroll from manufacturing enterprises employing 50 or more employees. The contributing company can reclaim up to a certain percentage of their contribution for training purposes. Since 1989, the industry's support in providing courses, equipment, and cash grants has totaled more than RM7 million. The federal government has invested more than RM17 million while the Penang state government has contributed RM5.8 million.

Since PSDC's inception, close cooperation between the state and federal government, industry, and academia has enabled PSDC to achieve the following milestones:

- Support from the industry in providing inputs on training, together with commitments by the state and federal government and academia.
- Recognition by the state government as the vehicle to realize human resource development for the industry.
- Acknowledgment by the federal government, notably the Former Prime Minister Dr. Mahathir, that PSDC is a good example of Malaysia Incorporated at work.
- Donations of equipment, training programs and funds by equipment suppliers, private training institutions and MNCs.

- "Anugerah Menteri Sumber Manusia 2000: Training Provide Category", an award accorded by the Ministry of Human Resource in acknowledgement of PSDC's contribution to the development of workforce.

*Second, a culture of cooperation among its industry members*. PSDC is managed by the Management Council comprising of 11 elected and 4 appointed office bearers and 7 ex-officio members. The office bearers are usually CEOs or very senior persons of founding or full-member companies. There is also a representative each from Penang state government, Penang Development Corporation (PDC), Universiti Sains Malaysia (USM), Sirim Berhad (formerly known as the Standards and Industrial Research Institute of Malaysia), Penang Regional Development Authority (PERDA), Ministry of Entrepreneur Development (KPU), and Small and Medium Industries Development Corporation (SMIDEC). These representatives are permanent members of the Management Council, acting in an advisory capacity to the Management Council in all matters related to government policies.

To link local companies with MNCs, PSDC often organizes tea-talks to bring the CEOs of MNCs and local suppliers to share ideas and exchange views. This helps local companies to join the supplier networks of MNCs. PSDC also maintains a database of skilled workers trained at PSDC. Job fairs are held annually to help students find jobs.

Third, a core of highly competent executives willing to contribute their time and knowledge selflessly to HRD. Initially, PSDC was established when the CEOs of Motorola, Intel and Hewlett-Packard formed a Steering Committee to set up a skills center. Manufacturing fraternity in Penang really cares about PSDC as its baby and nurtures it with further contributions in facilities, equipment, software and teach-ware. Penang Development Corporation (PDC), as a big brother to the industries, also plays its part to the extent of loaning its staff to PSDC. Investors and MNCs strongly believe in the consistency of Malaysian policies with the history of stability over the three decades. That is why they have been willing to invest in the technical training of their labor forces.

Regarding future development, PSDC is looking for a strategic partnership with technical colleges in advanced countries. This would

enable PSDC to offer higher degrees and diplomas and furher boost its position among other emerging training centers in Malaysia and neighbor countries.

## 10. Malaysia Industrial Development Authority (MIDA) in Penang

**Venue:** MIDA Penang
**Time:** 3 pm, January 13, 2006

**MIDA Penang Participant:**
Mr. Mohd Zukepli Bin Hj.Embong, Director, MIDA Penang

**Highlights:**

The Director explained the role of MIDA Penang. It is a regional office in charge of the promotion and coordination of industrial development in Penang. The office has four staff including one director, one secretary and two officers. It keeps the local government updated on the policies and incentives of MIDA, and helps the local government to follow up on the implementation of approved projects. It is the first contact point for investors who intend to set up projects in manufacturing and related services in Penang. It also provides consultation services to potential investors interested in Penang.

Regarding the advantages of Penang for FDI investment in comparison with other locations in Malaysia, the Director said that Penang was a very good location for investors since it boasted good infrastructure such as large ports, airport and highways. In addition, Penang was the state where the first economic zone in Malaysia was set up in 1971 to attract FDI. The former chief governor traveled to the US and Europe to invite big MNCs to Penang. While each state government has its own investment promotion program, there is no conflict among them in competing for FDI.

As for the past record and future prospects of Malaysia's economic competitiveness, the Director commented that Malaysia was not successful in creating large companies with globally-marketed high-quality products like South Korea. Malaysia is still behind other countries in terms of capability building, especially in high-tech industries.

# (3) Japan

## 1. VDF Tokyo special workshop

**Location:** GRIPS, Tokyo
**Time:** 9:30-11:30am, May 30, 2005

**Presenters:**

Mr. Le Van Duoc (Director, Department of Planning, MOI)
Dr. Cao Xuan Thanh (Deputy Director, Department of Planning, MOI)

**Participants:**
Kenichi Ohno (GRIPS/VDF), Yoshiaki Ueda (Univ. of Marketing & Distribution Sciences), Nozomu Kawabata (Tohoku Univ.), Tadashi Kikuchi (Keio Univ.), Yuji Sasaoka (GRIPS), Shuji Isone (Japan Carbon Finance), Fan Xiaoju (Waseda Univ.) Nguyen Thi Xuan Thuy (GRIPS/MOI), Azko Hayashida (GRIPS)

**Distributed:**

- "Workshop on Vietnam's Industrial Strategy, Planning and Policy Formulation by MOI Officials at GRIPS" (handout)
- MOI of Vietnam, "Vietnam Industry towards the year 2020" (powerpoint)

**Highlights:**
Mr. Duoc explained the general purpose of this mission and what he wanted to learn from Japan. Using slides, Dr. Thanh presented the achievements and structural transformation of Vietnam's industrial sector. The strategic vision, goal and implementation direction toward 2020 were also explained. Free discussion followed.

One participant asked about specific leading industries of Vietnam. MOI explained that there were three groups of industries: (i) industries that are already competitive and can lead the economy in the next five years or so (garment, footwear, food processing, etc); (ii) basic

industries (power, oil, industrial materials, etc); and (iii) leading industries (electronics, electrical, etc).

Another participant raised the issue of the recent power shortages in Northern Vietnam. If this situation continued, it would send a very negative signal to potential investors. MOI explained that power generation required huge investment and the government was trying to diversify financial sources for its development. According to the power sector roadmap, the public sector would be responsible for transmission only and other functions would be privatized in the future.

Ohno raised four issues on numerical targeting. First, what should be the scope of numerical targets (detailed targets for each sector and product, or only overall growth and exports)? Second, what should be done when targets were missed? According to Ohno, missed targets should be studied for future policy improvements rather than be met by any means. There should also be a layered structure of targets from a few key macro targets to industry-specific indicators and product-specific forecasts, each of which should be treated differently. Third, there seemed to be some classification problems (for example, crude oil or mining should not be included in the "industrial sector"). Fourth, would Vietnam really need the five-year plan after 2010?

The MOI side asked whether the number of numerical targets should depend on the stage of development. MOI also noted that, in the past, targets were treated as legal orders to SOEs but Vietnam was now moving towards softer recommendation. The five-year plan was also shifting towards orientation rather than strict targets. It was also argued that, for some material industries like steel and power, numerical demand forecasts and supply targets were still useful. One participant noted that capitalist states used only macroeconomic (fiscal and monetary) policies to influence industries indirectly. Others emphasized the difference between top-down targets and bottom-up targets, and the possibility of other targets like productivity.

The progress of SOE reform was also discussed. Vietnam was currently testing to convert some "decree 90" corporations into joint stock companies. If this proved successful, more "decree 90" corporations and even "decree 91" corporations might be equitized in

the future. MOI was also trying to transform EVN, PetroVN and Vinatex into "groups" (tap doan) of companies.

Other issues included (i) how much environmental concern was incorporated in industrial strategy; (ii) how to cope with international price fluctuation; and (iii) comparison with Chinese SOE reform.

After the workshop, the MOI delegation met GRIPS President Toru Yoshimura.

## 2. Technical Cooperation Bureau of METI

**Location:** Ministry of Economy, Trade and Industry, Tokyo
**Time:** 16:30-18:00, May 30, 2005

**METI participants:**

Mr. Hisanori Nei (Director, Technical Cooperation Division)
Mr. Tetsuo Ito (Assistant Director, TCD)
Mr. Toshihiro Kodama (RIETI Senior Fellow)
Mr. Mitsuhiro Yokota (Director for ASEAN Affairs)

**Mission members:** Duoc, Thanh, Ohno, Thuy

**Received:**

- TCD/METI, "Japan's Technical Cooperation Towards ASEAN, May 2005" (slide printout).
- Toshihiro Kodama, "Role of Government (Industrial Policy)" , excerpts from JCIP, Made in Japan, MIT Press, 1997.
- "Recent Developments under AMEICC", handout, March 2005.

**Highlights:**

Mr. Nei first explained about trade and FDI linkage within East Asia and METI's economic cooperation in the region. Mr. Yokota briefly explained about the AEM-METI Economic and Industrial Cooperation Committee (AMEICC).

According to Mr. Nei, after the negative impact of the Asian crisis was overcome, economic ties between Japan and East Asian developing countries strengthened. Japanese firms were again shifting production bases to East Asia, including some high-tech processes. Remaining concerns included legal frameworks, protection of intellectual

properties, customs procedure, FDI policy, human resource development, environment, waste management, and so on. Liberalization, facilitation and the sustainability of economic growth were three main concerns. METI's current policy orientation consisted of economic partnership agreements (EPAs, more commonly known as FTAs) and institutional improvements. The Japan-Vietnam Joint Initiative was one of such efforts.

The MOI team wished to see the 1998 trade flow data in the handout updated to a more recent year. It also wanted to know which products would be featured in the (current) second FDI wave from Japan to Vietnam.

Mr. Kodama discussed Japan's high growth era based on his paper. During the postwar period, Japan's main focus shifted as follows: (i) reconstruction (1945-52); (ii) regaining balance-of-payments autonomy (1952-60); (iii) shifting to an open system (1960-70); (iv) adjustment to the oil crises (1970s-early 80s); (v) international cooperation (late 1980s-); and (vi) revitalizing the Japanese economy (1990s-). He emphasized that, during the high growth era, the government used policy loans and tax measures to build infrastructure and assist the downsizing of declining industries. According to him, the view that Japan targeted specific industries was wrong. Policies such as tax incentives for R&D and machinery investment were general and available to all industries. Although selective interventions were attempted around 1960, they were rejected by the parliament or the business community. The visions presented by the government were not mandatory but only indicative. They helped to share future visions between the government and businesses.

The MOI mission remarked that building the government-business relationship was important, but reality was that all industries lobbied for government funds or tax cuts, which posed a headache for policy makers. Mr. Kodama noted that Japan did not offer favorable treatment to specific industries; any enterprise which satisfied certain criteria, in any industry, could receive support. More discussion on sector-specificity of industrial support ensued.

## 3. Waseda University (Prof. Tran Van Tho)

**Location:** Prof. Tho's office, Waseda University, Tokyo
Time: 10:30-12:00, May 31, 2005

**Waseda participant:** Prof. Tran Van Tho (School of Social Sciences)

**Mission members:** Duoc, Thanh, Thuy.

**Received:**

- "Phuong huong chien luoc cua Cong nghiep Viet Nam" ("strategical direction for Vietnam's industry", Prof. Tho's article released in The Saigon Times magazine on April 28, 2005, in Vietnamese).
- "Kien nghi khan cap voi CP ve: chien luoc, chinh sach can thiet de phat trien nganh dien, dien tu gia dung truoc thach thuc AFTA" (Urgent proposal to the Vietnamese Government on the strategy and policy to develop consumer electric and electronics industry under the challenges from AFTA), Prof. Tho's Letter to Mr. Tran Xuan Gia, Chairman of PM Board of Researchers, and Mr Hoang Trung Hai, MOI Minister, on May 25, 2005, in Vietnamese).

**Highlights:**
Prof. Tho discussed his activities as a member of the Prime Minister's Research Board in Vietnam since 1993. He stressed on the development of supporting industries as a potential break-through industry for Vietnam in the context of globalization.

Prof. Tho explained his two recent papers listed above and a plan to publish a book on Vietnam's economic and industrial development. He expressed concern over import tariff policy on the parts and finished products of consumer electronics.

MOI officials appreciated Prof. Tho's academic achievement and stressed that such studies were very useful for formulating strategies, master plans and other policy documents for the sake of Vietnam's industrial development up to the year 2020. More studies were encouraged and closer cooperation with MOI was recommended. It

was agreed that Prof. Tho should make a presentation on Vietnam's industrial development strategy at MOI some time this summer.

## 4. Japan Bank for International Cooperation (JBIC)

**Location:** JBIC Head Office, Tokyo
**Time:** 14:30-16:30, May 31, 2005

**JBIC participants:**

Mr.Yasunori Onishi (Dep. Director General, Develop. Assist. Dept. 2)
Mr. Takanori Satake (Senior Economist, JBIC Institute)
Mr. Shinji Kaburagi (Advisor, Corporate Finance Dept.)
Mr. Yoshifumi Omura (Dep. Director, Div.2, Develop. Assist. Dept. 2)

**Mission members:** Duoc, Thanh, Ohno, Thuy

**Received:**

- Takanori Satake, "Results of Survey of Overseas Business Operations by Japanese Manufacturing Companies: Vietnam and other Asian countries" (handout prepared for this mission).
- JBIC Institute, "Survey Report on Overseas Business Operations by Japanese Manufacturing Companies", Summary, Nov. 2004.
- JBIC, "Development of Vietnam Industry Sector" (handout prepared for this mission).
- Shinji Kaburagi, "Essence to make the best of the comparable competitiveness of the Vietnamese industry" (handout).

**Highlights:**

The JBIC side made three presentations on (i) the JBIC survey on Japanese manufacturers with particular attention to Vietnam (data received-see above); (ii) JBIC's approach to assisting Vietnam's industrial sector; and (iii) possibility of the ceramics industry.

Dr. Thanh asked if JBIC's manufacturers' survey differentiated north and south Vietnam since this distinction would be useful for policy makers. He also wanted to know if more investors were willing to come to Vietnam after mentioned weaknesses were corrected. JBIC responded that it was difficult to ask detailed questions for each

country since the questionnaire contained many questions and countries, and respondents were in company headquarters. Dr. Thanh also questioned why China, India and Vietnam were grouped together, and the answer was that these were countries that Japanese businesses were particularly interested as new FDI destinations.

JBIC noted that, unlike China and Thailand, Vietnam and India attracted much attention but reported few concrete investment plans. This was probably due to a time element, since it would take some time for investors to gather information and make plans for new host countries.

JBIC's assistance strategy for Vietnam was also discussed. Since SOEs were inefficient and the private sector was still small, it was considered essential that Vietnam absorb a large amount of FDI for industrialization. But not many investors come to Vietnam due to the lack of supporting industries and intellectual property right protection. Local firms should participate in the production network of FDI firms for achieving efficiency and competitiveness. Master plans for key industries, the Japan-Vietnam Joint Initiative, and JBIC's aid portfolio were also discussed.

Mr. Kaburagi emphasized the importance of understanding the taste of foreign customers and marketing to foreign customers' needs. Using the actual samples of ceramic bowls from Danang, he demonstrated that Vietnam had high potential in this industry if proper business orientation was in place.

Ohno noted that the proper use of numerical targets and the choice of leading industries were key issues in Vietnam. While numerical targets might not be suitable for highly developed economies, a country in transition might find them useful, if proper care was exercised. The scope and role of such targets and how to choose leading industries were the crucial question.

## 5. Honda Motor Co., Ltd.

**Location:** Honda Headquarters in Aoyama, Tokyo
**Time:** 10:00-12:00, June 1, 2005

**Honda participants:**

Mr.Koji Nakazono (General Manager, Overseas Operation Office no.2 - Asia & Oceania)
Mr. Hiroshi Nakagawa (Dep. Gen. Manager, Gov't & Industrial Affairs Office)
Mr. Shigeki Hayashi (Assistant Manager, Asean Motorcycle Dept, OOO no.2)
Mr. Cyril Aguadera (Coordinator, Asean Motorcycle Dept, OOO no.2), from Philippines
Mr. Issarapap Uchotananan (Coordinator, Asean Automobile Dept, OOO no.2), from Thailand
Mr. Junji Hida (Assistant Manager, Asean Motorcycle Dept., OOO no.2)
Asimo (Honda robot)

**Mission members:** Duoc, Thanh, Ohno, Hoang, Thuy

**Received:**

- Presentation hardcopy (no title) by Asean Motorcycle Division, Honda.
- Honda Corporate Profile.
- Honda Annual Report 2004.

**Highlights:**

The mission was greeted by large Japanese and Vietnamese flags and Asimo, Honda's human-type robot. A corporate video was shown, and Mr. Aquadera presented Honda's automobile and motorbike strategies using slides.

Mr. Nakazono welcomed the mission and thanked Vietnam for granting Honda a license to start automobile production (dated March 2005). Mr. Nakazono said that Honda very much hoped to contribute to Vietnam's industrialization and asked for further assistance of the Vietnamese government. He hoped to exchange information and continue talks with the government. He also noted that Honda was the only company that sponsored a large-scale TV campaign for traffic safety in Vietnam.

As to the motorbike, Honda noted that the recent removal of quota restriction on imported parts was very good news. This eliminated the

largest obstacle for expanding production. With rising output, Honda's localization has already reached over 80%, and exports to the Philippines and Laos began.

Other topics such as Honda's future business plans in Vietnam and other countries, as well as remaining issues, were extensively and concretely discussed (not recorded here).

## 6. Japan External Trade Organization (JETRO)

**Location:** JETRO Headquarters, Tokyo
**Time:** 10:00-12:00, June 1, 2005

**JETRO participants:**

Mr.Ryo Ikebe (Chief Dep. Director, Trade and Economic Cooperation Div.)
Mr. Koji Ida (Assistant Director, Asia & Oceania, Overseas Research Dept.)
Mr. Satoshi Kitashima (Asian Cooperation Div., TECD)
Ms. Dao Uyen Phuong (Asian Cooperation Div., TECD)

**Mission members:** Duoc, Thanh, Ohno, Hoang, Thuy, Mori

- Koji Ida, "Vietnam's Investment-Related Environment for Japanese Companies".
- Overseas Research Department, JETRO, "Japanese-Affiliated Manufacturers in Asia: ASEAN and India (Survey 2004)", March 2005.

**Highlights:**

Mr. Ida first presented the evaluation of FDI destinations (including Vietnam) based on the JBIC survey (see the meeting record with JBIC above). Discussion followed.

MOI wondered why the average size of FDI coming to Vietnam was becoming smaller. As to the changeable policy environment, MOI said that the government did not wish to change policies frequently but this was inevitable when external environment changed. MOI was searching for appropriate industries to support (footwear, garment, electronics, food processing, etc), and they hoped to receive global market forecasts for key industries. However, JETRO did not have such

forecasts. Ohno noted that evaluating the potentiality of industries from global forecasts was difficult since Vietnam's performance would not be in parallel with global market expansion.

Mr. Ikebe felt that by now Vietnam already had a fairly good FDI environment. He thought that Vietnam's growth in the last ten years was very impressive and its economy was full of dynamism. He was certain that export processing would expand in the future. Mr. Ikebe also said that enterprises in Vietnam should procure parts not only domestically but also from China and ASEAN for building regional business networks.

Mr. Kitashima remarked that Vietnam's supporting industries remained very weak and could not compete globally unless they improved technology and quality control. Measures to improve supporting industries were discussed, including the vendor company database and reverse trade fairs by JETRO. Ms. Phuong is in charge of such fairs and another fair will be held in Hanoi later this year.

## 7. Research Institute of Economy, Trade and Industry (RIETI)

**Location:** METI Annex, Tokyo
**Time:** 9:30-11:00, June 2, 2005

**RIETI participant:** Mr.Susumu Sanbonmatsu (senior researcher)

**Mission members:** Duoc, Thanh, Ohno, Hoang, Mori

**Received:**

- A memo on the "Study plan on the global management and innovation of Japanese enterprises" (Japanese).
- Susumu Sanbonmatsu, "Innovation and organizational and management reform: the case of the electrical industries", RIETI Discussion Paper Series 05-J-003 (March 2005, Japanese).

**Highlights:**
Mr. Sanbonmatsu presented the general framework of his research. Each MNC follows its own strategy while responding to changes in business environment. Business style is defined by markets, product line, and value chain positioning. To realize the chosen business style,

each MNC determines management style, design organization and operational processes, and exercise organizational capabilities.

For dynamic competitiveness, two global chains-global innovation chain and global supply chain-are particularly important. To introduce new products continuously, MNCs must always plan and invest ahead for each market. With Japanese MNCs, business architecture for initial product development is often integral but later expansion is based on modularization. Basic platforms may remain the same but additions are made to serve markets in different countries. For efficient production, MNCs must allocate different productive functions to various countries properly for inventory reduction, labor cost reduction, quality, and speed. Leadership and corporate culture (internal common value) are particularly important. If an MNC has strong lead rship and corporate culture for progressive innovation, it can rearrange management resources, redesign organizational structure and power, and alter the resource allocation principle.

MOI wanted to know what Vietnamese firms should do to participate in these chains. Mr. Sanbonmatsu replied that strategies depended on whether products were for export or domestic supply. Clustering is particularly important, and policies for supporting industries and HRD can promote its formation. When and how Vietnamese firms can enter the global value chain depends on each sector. For automobiles, there is already an extensive global production network spanned by MNCs and the question is how to participate in it. For electronics, acquiring proper skills and technology is key. For software, human resources are crucial. In all cases, an efficient electronic communication network was necessary to join the global chain.

## 8. Automobile Division of METI

**Location:** METI, Tokyo
**Time:** 14:00-15:30, June 2, 2005

**METI participants:**

Mr. Makoto Watanabe (Director for Automobile Policy Planning)
Mr. Junichi Iwasaki (Assistant Director, Automobile Division)
Ms. Atsuko Yoshida (Technical Cooperation Division)

Mr. Tetsuo Ito (Assistant Director, Technical Cooperation Division)

**Mission members:** Duoc, Thanh, Ohno, Hoang, Mori

**Received:**

- METI profile brochure, 2004.
- Makoto Watanabe, "Current Status and Challenges of the Japanese Automobile Industry Policy", prepared for this mission.
- JAMA, The Motor Industry of Japan 2005 (bilingual J & E).
- METI, Guide to the Research and Statistics Department, 2004.

**Highlights:**

Japan's automobile policy in the past and at present was explained. For METI, "surrounding policies" on air pollution, fuel efficiency and traffic safety were historically very important. For these, METI set standards under close consultation with producers. The deliberation council played a crucial role in private-public cooperation in the 1960s. For air pollution, the emission control law was enacted in 1973 which was tightened subsequently. Fuel efficiency was achieved by benchmarking the most efficient producer (top-runner system). Diesel regulation and clean fuel requirements were promoted with tax benefits. More recently, the intelligent transport system and the electronic toll collection (ETC) system have been promoted. Generally, under increasing globalization, the role of METI has included (i) trade negotiations and indicating clear trade liberalization schedules; (ii) coping with energy and environmental issues; and (iii) improving business environment in the Asian region. The government has had no major role in business strategy or promotion of the car industry since private enterprises decide them.

The mission asked whether policies were made by METI or other ministries. METI responded that it all depended on the issue. METI was responsible for technology, safety standards and trade negotiations. Traffic, environment and other issues were handled by other ministries. Inter-ministerial cooperation has been good. Drafted laws were sent to the Cabinet and then to the Parliament for approval and implementation.

Japan has had a long history of promoting supporting industries. The law for rationalizing parts industry and the SME Agency provided

many supporting measures. METI advised that upgrading skills of workers and enterprises was crucial for Vietnam.

The mission asked about controlling traffic congestion. METI replied that the number of cars was only a minor issue. For proper traffic policy, the development strategy for roads and railways is crucial. Infrastructure, traffic control system, urban planning and education are all needed. Japan never restricted the registration of motor vehicles since the freedom of business enterprise was so basic to Japanese policy making. Jakarta, Bangkok and Singapore restrict traffic entering urban centers, but not the total number of cars. According to METI, congestion is a traffic control problem, not a problem of the car industry.

The mission also inquired about channels with the private sector. Drafted laws are always discussed at an official open committee and also receive public opinion for at least one month. For FTA negotiations, METI communicates with the industry via telephone, email and informal meetings to summarize Japan's position before going to the negotiation table. For data collection, there is a law that requires monthly submission of basic data by enterprises. Such data come automatically but with delay. The Japan Automobile Manufacturers Association (JAMA) reports basic data much faster. JAMA also plays a key role in linking government and businesses. If METI needs specific or sensitive data, the reason must be explained. If there is a good reason, businesses will cooperate. Otherwise, they don't. METI usually works with JAMA but sometimes approaches individual companies directly. The mission noted that, in Vietnam, MOI did not contact individual enterprises for policy purposes.

## 9. Information & Communications Electronics Division of METI

**Location:** METI, Tokyo
**Time:** 15:30-17:00, June 2, 2005

**METI participants:**

Mr. Kazuo Yokota (Deputy Director for International Cooperaton, Information Policy Division)

Mr. Toshihiko Tamura (Deputy Director, Information & Communications Electronics Division)
Ms. Atsuko Yoshida (Technical Cooperation Division)
Mr. Tetsuo Ito (Assistant Director, Technical Cooperation Division)

**Mission members:** Duoc, Thanh, Ohno, Hoang, Mori

**Received:**

- METI memo, "On information policy: past policy trends and future direction", Nov. 2004 (Japanese).
- T. Kodama, H. Ueda, and T. Sunada, "Agenda for Industrial Policy in East Asian Countries", RIETI studies in international trade and industry no.16, 1994.

**Highlights:**

The history of Japan's electronics industry promotion was explained. A shift from heavy industry to the electronics industry was promoted, and locally produced computers were encouraged in the 1960s-80s. Coping with IT innovation, and trade talks on intellectual property rights and semi-conductors were main issues in the late 80s to early 90s. From the late 90s to 2000, e-business was promoted as internet became popular. At present, the e-Japan strategy is METI's main concern. This strategy was explained in detail.

The e-Japan strategy, formulated in 2001, aimed to make Japan a frontline IT nation by 2005. The government created the IT Strategy Headquarters, IT Basic Law, and IT Strategy. It also supported the building of IT infrastructure. One of the targets, creating fast internet (broadband) environment, was already achieved by 2003 in terms of speed and price. For this reason, the policy focus has shifted to the user-side issues including provision of contents, platform, and information services.

METI's policy is conducted in continuous circles: the process of evaluation, goal-setting and implementation is repeated to revise the strategy. The typical policy cycle for electronics lasts 1 to 3 years depending on the targeted product or service. Immediate targets and longer-term goals are distinguished, but the important thing is that policy cycles ensure quick and flexible response to changing situations

and achievements. Goals, periods and criteria are constantly revised. Numerical targets are sometimes used (for health services, for example) but not very often.

The deliberation council on industrial structure concluded in its report in April 2005 that Japan was strong in hardware but weak in IT services. Moreover, it was pointed out that all Japanese manufacturers produced similar IT products leading to excess competition and reduced prices and profits. By contrast, foreign companies such as IBM, Intel and Samsung concentrate on core businesses and generate large profits. For METI, it is difficult to tell Japanese companies to produce what and what not. But if private companies collectively express desire to avoid overlapping in product lines, the government can support their effort. This can be done through publishing official reports, monitoring R&D, and deregulating the industry upon businesses' equest.

Japan's promotion measures are basically the same as in other countries. METI uses tax reduction for introducing IT systems, tax incentive for IT investment, subsidies for developing LSI circuits, and subsidies for IT training of SMEs. Some of the IT training programs are subsidized by prefectures (local governments). METI also supports individuals who get IT licenses and qualifications.

## 10. Manufacturing Management Research Center (MMRC)

**Location:** MMRC Project Office, Tokyo
**Time:** 10:30-12:15, June 3, 2005

**MMRC participants:**

Prof. Takahiro Fujimoto (executive director)
Mr. Ge Dongsheng (researcher)
Mr. Hai (Tokyo University)

**Mission members:** Duoc, Thanh, Ohno, Hoang, Mori

**Received:**

- MMRC profile (English and Japanese)
- Takahiro Fujimoto, “A Twenty-first-Century Strategy for

Japanese Manufacturing", Japan Echo, Feb. 2004 (English).

- Takahiro Fujimoto, The Monozukuri (manufacturing) Philosophy of Japan, Nihon Keizai Shimbunsha, 2004 (Japanese).
- Takahiro Fujimoto, Architecture-based Analysis of Chinese Manufacturing Industries, RIETI/Toyo Keizai Shimposha, 2005 (Japanese).

**Highlights:**

MMRC is the office of the 21st Century Center of Excellence (COE) Project managed by the University of Tokyo and headed by Prof. Takahiro Fujimoto, the leading authority on business architecture theory[34].

The purpose of this project is to document the integration-based Japanese manufacturing system in detail. Integral business architecture is the source of strength of Japanese MNCs. Prof. Fujimoto's hypothesis is that proper matching of product type and firms' organizational capability generates competitiveness. Organizational capability is country-specific. Japanese and Chinese business styles are different, and trade between the two countries is therefore basically complementary. This can be regarded as a new theory of comparative advantage based on business architecture.

The actual operation of integration-based manufacturing is often unrecorded. This COE project attempts to put it into words. For this purpose, sixteen Japanese MNCs including Toyota, Canon, Honda, Matsushita, Sony, etc. form a consortium and monthly meet at this office. Prof. Fujimoto gave some examples of architecture-based analyses including (i) criticism of full-set mentality; (ii) Toyota teaching a good company to become even better; (iii) Toyota-Dell comparison; and (iv) invalidity of current industrial classification.

[34] VDF is part of another 21st Century COE Project managed by GRIPS and headed by Prof. Kenichi Ohno. This meeting exchanged information and views of two COE projects.

Ohno raised four issues related to business architecture dynamics in developing countries. First, whether modularity-based local firms can survive WTO and FTAs or they will be eliminated (example: Vietnam's motorbike industry)? Second, Prof. Otsuka and Prof. Sonobe of GRIPS identified a common 3-stage pattern of industrialization in developing countries: (i) rise of an initiator; (ii) expansion of copy production with low quality and low price; and (iii) emergence of an innovator to raise quality and competitiveness. The key question is whether transition from (ii) to (iii) requires FDI or it can be done locally. Third, architectural evolution is private sector-driven in Japan, but it may require policy intervention in developing countries. Fourth, can Japan's integral businesses be combined effectively with production in ASEAN (including Vietnam)?

Prof. Fujimoto (as well as Profs. Otsuka and Sonobe) argued that ODA should be used to help developing countries climb the three stages noted above. However, Ohno cautioned that it was very difficult to distinguish unproductive copycats from innovative imitators. If ODA is used to help unproductive copycats, it will fail. Prof. Fujimoto agreed that this distinction was important. He added that the quality of initiators and innovators was also critical. He thought that US-China (modular) and Japan-ASEAN (integral) were potentially suitable production partners. If Thailand and Vietnam acquire additional capability required for integration-based manufacturing, they will become Japan's good manufacturing partners. For this, key elements are transfer of design and engineering capability from Japan to ASEAN, promoting manufacturing-related HRD with ODA, and accumulation of firm-specific knowledge by reducing job hopping.

Prof. Fujimoto is particularly interested in the motorbike industry and visits China and India often. He also came to Vietnam and visited Thang Long Industrial Park. Toyota is inviting Prof. Fujimoto to lecture in Vietnam (end 2005?). Ohno asked him to contact VDF before coming to Vietnam to arrange additional activities. Prof. Fujimoto's COE project will continue until 2007. He hopes to find another funding after that.

## 11. Development Bank of Japan (DBJ)

**Location:** DBJ, Tokyo
**Time:** 14:00-16:00, June 3, 2005

**DBJ participants:**

Mr. Masahisa Koyama (Director Gen., International & Cooperation Dept, DBJ)
Mr. Hirohiko Sekiya (Senior Executive, Japan Economic Research Institute)
Mr. Kojiro Sakurai (Senior Economist, RICF, DBJ)
Mr. Takashi Sasano (Senior Economist, RICF, DBJ)

**Mission members:** Duoc, Thanh, Hoang, Mori

**Received:**

- M. Koyama, "Japanese industrial policy and DBJ loans in the postwar period".
- H. Sekiya, "Industrial policy and policy-based finance in Japan".
- K. Sakurai, "Theoretical explanation of industrial policies in postwar Japan".
- T. Sasano, "Industrial cluster policy".

**Highlights:**

DBJ participants delivered their presentations in the order of received materials above. Most of the information was on the past experiences of Japan but some materials were about more recent periods.

Mr. Koyama's presentation made clear that Japan did have some period (1958-1962) of numerical targeting for development. More specifically, annual targets included: (i) export growth of 10.5%; (ii) growth in gross capital formation of 4%; (iii) growth in value-added of 10.5% for heavy and chemical industry and 5.3% for light industry; and (iv) growth in private consumption of 5.5%.

Mr. Sekiya discussed IT promotion loans as an example of a successfully implemented industrial policy. In addition, two interesting issues were raised: the practical processes of industrial policy in its formulation and implementation, and key factors for successful implementation of industrial policy under financial and SOE reforms.

Mr. Sakurai explained that the method of income elasticity of demand was used to identify infant industries that should be supported by the Japanese government in the postwar period. It was interesting to know that the government did come up with a reason (though not accepted by all) to support some industries but not others in certain periods. In addition, shingikai (deliberation council), a committee set up by a relevant ministry, provided a means to exchange information between government and the private sector.

Mr. Sasano's presentation showed that Japan was now actively incorporating the industrial cluster approach into its industrial policy. Two recent industrial cluster policies in Japan, in 2001 and 2002, were presented. The mission noted that the idea of industrial clusters was also extensively used in the Malaysian Industrial Master Plan 2 (1986-2005) drafted more than ten years ago.

Due to a time constraint, the DBJ participants and the mission did not have enough time for discussion. Both sides agreed to keep contact via email and other means.