

GRIPS Development Forum Policy Minutes

No.10

October 2002

Foreword

The Japan International Cooperation Agency (JICA) has since 2000 been conducting a joint research project on Vietnam's trade and industrial policies under international integration with the participation of Japanese scholars and Vietnamese researchers from the National Economic University, Hanoi. This project inherits the spirit of JICA's previous joint research project with Vietnam (the so-called "Ishikawa Project," 1995-2001), including real-sector orientation, emphasis on field works, and the fostering of long-term and mutually respecting relationship with our counterparts.

We would like to publish some of our policy discussions in the National Graduate Institute for Policy Studies (GRIPS) policy minutes series to introduce the concrete contents of our policy dialogue and invite comments and suggestions from the fellow experts and policy makers.

For more details on the project, please visit:
<http://www.neujica.org.vn/>

October 2002
GRIPS Development Forum

A Symposium
on
Industrial and Trade Policies of Vietnam
under International Integration

MINUTES OF MEETING

Hanoi, March 29-30, 2002

National Economic University
Japan International Cooperation Agency

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Opening remarks by:

His Excellency Mr. Ryuichiro Yamazaki, Japanese Ambassador to Vietnam

Prof. Dr. Vu Ngoc Nhung, Vice Minister of Education and Training

SESSION 1 : OVERVIEW AND MAJOR RECOMMENDATIONS

(March 29, 2002, morning)

Presentation by Prof. Kenichi Ohno, National Graduate Institute for Policy Studies (GRIPS)

This research project between NEU (:National Economic University) and JICA (:Japan International Cooperation Agency) was organized to produce concrete policy advice for Vietnam's industrialization under integration. We conduct in-depth studies respecting the individuality of each industry. Twenty-nine researchers from Vietnam and Japan participate in this project. We disseminate output through various channels including a web site and seminars like this. My role is to summarize our current views and recommendations.

The market must be the main engine of growth. But where the private sector is weak, the government has important roles in fostering markets and managing integration. We reject both full control and full liberalization. Liberalization must be strong enough to provide incentives for reform, but it should not be too drastic to cause social problems. This delicate role of government in a developing country is what we want to convey. There is much room for improvement in Vietnamese policies.

Integration for a latecomer country is a process of great self-transformation under foreign pressure. This tends to create dual structure according to the degree of foreign penetration. Vietnam's manufacturing sector is also split into two parts: the protected domestic sector and the open export sector. They operate independently now, and Vietnam's challenge is to link them by improving domestic capability.

The key to Vietnam's industrialization is FDI (:Foreign Direct Investment) policy. FDI dynamics is a very complex one in which two forces of *agglomeration* and *fragmentation* interact. Vietnam should first accumulate a critical mass of assembly-type FDI. This will open up the possibility of creation of supporting industries and, later, technology transfer. Do not try to jump to the last stage without sufficient FDI accumulation. To attract FDI, the government must actively build good environment and reduce the cost of doing business. The policy of free trade and investment is not enough.

By contrast, industries producing for domestic markets are now protected. Foreign and Vietnamese firms in these industries must be given clear timetables for the removal of protection. For industries with realistic restructuring plans, the government may temporarily support them in exchange for such efforts.

We also have specific advice for individual industries. In textile and garment as well as in steel, for example, the Japanese advice is different from the current government policies. The details will be presented in later sessions, today and tomorrow.

Mr. Tran Dinh Thien, *Institute of Economic Studies*

We appreciate very much the presentation of Prof. Ohno. May I ask some questions? First, does the essence of your proposal contradict with Vietnam's commitment to free trade? Is there not a dilemma between industrialization under protection on the one hand and globalization on the other? I wonder if your project is also considering the issues of institutional reforms and incentive policies as well. Second, Prof. Ohno mentioned the sequencing from assembly to parts production, and finally to technology absorption. But we need clear criteria for moving from one stage to the next. We have to specify the timing from the viewpoint of technology.

Prof. Ohno

In theory, there seems to exist a dilemma between globalization and protection. But in practice, there is no such dichotomy; the two policies must always be combined properly. We can say that a country with good preparation should be able to go far in globalization. The problem is that, for many countries, globalization proceeds too quickly without preparation. The preparation includes not just new laws and institutions but also industrial competitiveness. How to combine globalization and protection in each individual case is more important than trying to choose between 100% globalization and 100% protection. When we study specific industries and products, we will see that both are needed but with different proportions. On the second point, I agree completely. That is exactly what we are studying. At present we do not have concrete proposal for timing (except steel, below). But in the rest of this year, we will continue to prepare such schedules for key industries. To present concrete timetables for integration, we need to study hard to understand deeply the local industries as well as global market trends.

Mr. Nguyen Quy Son, *General Secretary of Vietnam Electronic Industries Association (VEIA)*

Vietnam's electronics industry is assembly-concentrated and foreign-dominated. Foreign firms produce hardware, but the government emphasizes software. However, we have only a few SMEs (:Small and Medium Enterprise) and SOEs (:State Owned Enterprise) in the software industry. Prof. Ohno suggested that Vietnam should identify its proper position in the global electronics industry to design appropriate policies. According to Japan's experience, what is the current position of Vietnam's electronics industry in the world?

Mr. Nguyen Xuan Hoa, *Vice General Secretary of the Vietnam Association of Textile and Garment*

Prof. Ohno suggested that the textile and garment production in Vietnam should focus on downstream processing. What is the basis of this recommendation? In deciding the development path of the textile and garment industry, we need to consider many factors. And the most important among them is the internalization of production and the increase of domestic content.

Prof. Yumiko Okamoto, *Nagoya University*

For electronics, there will be a detailed presentation this afternoon. It is true that the major driving force of Vietnam's electronics industry at present is multinational companies. Vietnamese experts may be worried that the industry is dominated by foreigners. But we need to look at the experiences of other ASEAN (:Association of Southeast Asian Nations) members. At first, they invited as many MNCs (:Multinational Corporation) as possible. Secondly, they tried to establish linkage between local SMEs and large MNCs. What Vietnam should do is first to attract foreign firms and next to improve domestic capability. We cannot do everything at once, and the sequence is very important. For this, Vietnam needs to have a good development strategy for the electronics industry.

Prof. Ohno

I would like to add that all our recommendations for electronics, textile and garment, and other industries are based on international experience and the analysis of global and regional forces, not just domestic factors.

Let me give you an example. For textiles, we do not support "internalization," or investing upstream, for the following reasons: Vietnam is rich in human resources and poor in capital, but upstream investment requires a lot of capital. There are already many countries that produce good textile, and it is very hard to compete with them in price and quality.

Moreover, if you sink your money into big capital equipment and if the global condition changes, you cannot switch to another strategy. Before investing so much, Vietnam can do many things to improve competitiveness in garment manufacture. The productivity of Vietnamese garment workers is low compared with China. To improve this, better production management is needed, not large capital investment. At present, Vietnam depends entirely on foreign partners for marketing and input procurement. Why not start to learn these from them, step by step, which will raise domestic content, reduce foreign partners' operation cost and attract more FDI? The Vietnamese side can also take up designing, accessories, dyeing, and factory management in proper speed and sequence.

In the age of globalization, raising value-added does not necessarily mean investing upstream. You should not try to internalize the whole industry. Even for one product, there are many stages of production with different labor and capital requirements. Concentrate on the process you can perform well, and do it even better. If Vietnam focuses on the processes requiring a lot of high skilled labor, it should do very well in the future.

SESSION 2 : WTO, AFTA AND FDI

(March 29, 2002, morning)

Presentation by Prof. Mai Ngoc Cuong, National Economic University

Integration is an urgent requirement for Vietnam. Despite the recent efforts of both government and enterprises, their preparation still cannot meet the challenges of integration adequately. Therefore, the preparation for economic integration should be accelerated. This requires continued endeavors by both government and enterprises.

For the government, appropriate strategies for economic restructuring under AFTA (:ASEAN Free Trade Area) and WTO (:World Trade Organization) should include: (1) building a long-term comprehensive plan for regional integration; (2) regulating the direction of investment for systemic transition and development of potential advantages of the economy; (3) upgrading business environment including credit access by non-state enterprises and tax rate adjustment; and (4) trade related measures such as removal of NTBs (:Non-Tariff Barrier), shift from positive to negative lists, transparency in trade laws, etc.

For enterprises, appropriate strategies should be: (1) enhancing enterprises' quality and effectiveness; (2) designing business strategies for most effective targeting in the long run; (3) renovation and modernization of technology and achievement of low cost; and (4) enhancing quality and management of labor resources at enterprises.

Presentation by Prof. Okamoto (on behalf of Kimura)

Let me present the paper on FDI strategy by Prof. Fukunari Kimura, who is absent. My own presentation on the electronics industry is scheduled this afternoon, but the first half of my presentation is related to Kimura's ideas. The difference between the ASEAN model on the one hand and the Japanese or Korean ones on the other is that the latter separated export and domestic markets in industrialization strategy. To promote exports, instead of waiting for local firms to grow up and penetrate the world market, the ASEAN countries established EPZs (:Export Processing Zone) to attract FDI and let foreign firms produce for the world market. Then they tried to strengthen the linkage between the domestic and international sectors. Vietnam should follow the ASEAN model for industrialization.

The question is what type of industrial policies Vietnam should adopt today. The most important recommendation by Prof. Kimura is to design new industrial promotion policies centered on FDI accumulation. Vietnam is facing new challenges which were not

experienced by the other East Asian countries in the past. The forces driving FDI are changing: there is more competition for FDI attraction among developing countries; unskilled labor alone is no longer enough to attract FDI. To attract export-oriented FDI, Vietnam must become the best (or second best) location in the world. For this, the key is to provide good infrastructure services and good policy environment. Additionally, supplying more skilled and educated workers as well as development of intermediate inputs will attract more FDI into Vietnam.

Mr. Peter Sturm, Ph.D, *German Development Service and Central Institute of Economic Management*

Let me raise two questions. First, Prof. Ohno advises that Vietnam should concentrate on assembly now and not parts. Does this mean that Vietnam should refuse investment projects in parts? It is for private firms, not government bureaucrats, to decide what investment they will make. There should be no selectivity in attracting FDI. Second, if you permit protection in import-substitution industries, this tends to attract uncompetitive projects, leading to a waste of capital.

Prof. Okamoto

There should be a clarification of terms. Vietnam has both assembly of final products and assembly of parts. The distinction between assembly and parts, therefore, is not really correct. What I am saying is that the Vietnamese government should try to attract as many FDI projects as possible. Of course the business sector is in the best position to decide the type of FDI. But the government has also to play the role by preparing good environment and infrastructure.

Ms. Karolyn L. Gates, PhD, *Multilateral Trade Policy Assistance Program (MUTRAP), EU*

Prof. Kimura's paper says that Vietnam should be the No.1 or No.2 location for FDI. But locational advantages shift dynamically and specific measures required may differ from one industry to another. Telecom may be the key for one industry, but a good road system may be more important for another. I feel that policy to target particular industries in this way is difficult to realize.

Prof. Okamoto

Perhaps the way I presented Prof. Kimura's ideas was somewhat misleading. In the new competition for FDI, how you attract FDI depends very much on the type of industries and, even within an industry, on the particular production process. I am not saying that Vietnam's government should prepare everything.

Dr. Nguyen Duc Kien, *Economic Research Agency of the Vietnam Communist Party*

I would like to raise a point of clarification. It is proposed to let the private sector decide what kind of investment they should make. But I want to refer to a situation in Vietnam and ask for your advice. The very first group to oppose the tariff reduction under AFTA framework was FDI firms in Vietnam. They asked the government to raise import tariffs to protect their production. Chemicals and motorbikes were examples of these. In the current transition process, where is the boundary between government and private decisions, and to what extent should the government intervene in the market?

Prof. Ohno

We are not asking the Vietnamese government to screen FDI. On the contrary, we are complaining that the government is screening too much, especially in imposing local contents. Our main argument is that Vietnam should first establish an FDI attraction policy without selectivity. Under import protection, as noted by Dr. Kien, some FDI firms come to enjoy high protection, and they often lobby against trade liberalization. This type of protected FDI should be clearly distinguished with export-oriented FDI which operate under open and competitive environment. For protected FDI, a clear timetable for reducing protection including both tariffs and NTBs should be announced. The government should respect international commitments.

Mr. Thien

Prof. Kimura's paper suggests that Vietnam should follow the ASEAN model for attracting FDI and achieving industrialization. But this may not be the right model for Vietnam. The Asian financial crisis revealed the risk of adopting the model which may have succeeded in other countries. First, in the earlier period, the East Asian countries industrialized under high tariffs. But now, Vietnam has to reduce protection within a short time, so the same model cannot be used. Second, capital mobility has increased dramatically. Third, this is the age of the knowledge economy, but Vietnam lags far behind in this area. To catch up,

Vietnam needs a medium-term strategy for moving from simple assembly to high-tech. As the world changes, the model for attracting FDI in particular, and the development strategy in general, must also change. Therefore, with respect to the Kimura paper, I would like to ask: can Vietnam really apply the ASEAN model? If not, what model should developing countries adopt in the age of globalization and knowledge economy?

Vietnamese participant

I agree fully with Mr. Thien. We have relied too much on past experiences, but what Vietnam needs is new creativity for its development. FDI attraction must be balanced with the government's own vision about Vietnam's development. Even under WTO, the government should give directions so that our path will be knowledge- and technology-based and inputs and upstream processes are internalized.

Prof. Ohno

The two previous speakers hope to maintain Vietnam's autonomy in the process of industrialization. I can understand that, but policy independence must be realized in a way consistent with FDI dynamics. The oriental saying teaches that, to control the flow of water, we need to work with the nature of water, not against. Vietnam's autonomy must be realized by guiding FDI, not dictating it.

Prof. Okamoto

Let me stress three things in clarification of the ASEAN model. First, the other ASEAN countries did not lift protection immediately. Second, strategies for export-oriented industries and import-substitution industries must be clearly distinguished. Third, Vietnam has much less time to implement free trade than the other ASEAN countries.

SESSION 3 : ELECTRONICS INDUSTRY

(March 29, 2002, afternoon)

Presentation by Dr. Nguyen Ngoc Huyen, National Economic University

The electronics industry has grown strongly since 1990, in terms of both production capacity and number of enterprises. To date, there are approximately 200 enterprises, of which state enterprises account for a half. Most enterprises are small-scale assemblers. Enterprises in the South account for 75% of total electronics output. Foreign-invested enterprises dominate, while state enterprises and domestic private enterprises account for a small proportion of output.

In terms of technology, it remains a labor-intensive industry in which CKD (:Complete Knock Down) assembly accounts for 80% of total. Simple labor is Vietnam's largest input. While the government desires to promote the industry, the strategy is formed at national or ministerial level with very general directions. The government has revised its policy orientation from import substitution to export promotion.

Despite the advantages of cheap labor and the government's promotion, Vietnam's electronics industry faces many challenges: (1) market imbalance; (2) inherent disadvantages of a late starter; (3) unskilled labor with little discipline; (4) poor infrastructure; (5) weak macroeconomic management; and (6) the weakness of state electronics enterprises.

From the current situation, taking into account the potential and the targets of the industry, we would like to propose some measures. The government needs to stimulate FDI in original parts production, promote technology transfer, build necessary infrastructure, and support trade in the electronics industry. Additionally, domestic investment should be promoted. For copyright protection, the legal environment must be improved by strengthening the legal protection institutions and the fight against smugglings and counterfeits. Finally, the development of human resources must be accelerated.

Presentation by Prof. Okamoto

Global electronics production is entering a new stage with (1) globalization of production; (2) new factors dictating the location of MNCs; and (3) emergence of China as an industrial power. The driving forces of this industry are MNCs. In Vietnam, the share of MNCs in total manufacturing rose from 1.3% in 1996 to 4.4% at present. Even so, Vietnam's share in East Asian electronics production is very small. Although electronics appears to be one of

the leading industries in Vietnam, its size is minuscule by the Asian standard. New opportunities generated by both international and regional changes have not been fully captured by Vietnam. Development of the electronics industry in Vietnam is constrained by (1) high cost of doing business; (2) lack of promotion; (3) underdeveloped infrastructure; (4) strict local contents requirement; and (5) bureaucracy.

In Vietnam, office rents are about the average of ASEAN but higher than in ASEAN4. Phone charges are the second highest in the region. Electricity is also expensive. Local transportation costs more than transoceanic shipping. All these offset the advantage of cheap and skilled labor.

My suggestions for Vietnam's electronics industry are as follows: up to 2006, Vietnam should attract as much electronics FDI as possible. This should be done by cutting the cost of doing business, improving the quality of government services and removing various disincentives in production. In the medium to long term, Vietnam should gradually introduce selectivity and support the development of SMEs.

Mr. Sadanori Watanabe, JICA expert and VCCI

Let me say a few words from the private sector's viewpoint. Vietnam's electronics production is only in assembly. Further development requires parts industries. To build such industries, the government must clarify its policy and offer good incentives. But not much time is left for Vietnam to do this. It is very important to distinguish electronics for exports and electronics for domestic sales.

Prof. Nguyen Ke Tuan, National Economic University

Let me ask some questions. First, I understand that the electronics industry is characterized by rapid change and short product cycles. How do you assess the competitiveness of Vietnam's electronics in the globalization age, in the domestic as well as foreign markets? Vietnam currently does only assembling, which is old technology. Second, Dr. Huyen's presentation seems to emphasize the closed circuit of production from A to Z. In the mean time, Prof. Okamoto suggests that Vietnam must become one link in the international division of labor. Third, Dr. Huyen's forecast is too optimistic, especially the export demand of USD 2 billion by 2005. Fourth, R&D (:Research and Development) should be included in the development strategy since this is very important. How do you assess its possibility in the Vietnamese context?

Mr. Tran Dinh Thien

I agree that the electronics industry must be given priority. Concerning Dr. Huyen's presentation, the strategy should be more specific. For instance, what are the conditions for successful implementation of the measures proposed, what is the technology needed for the proposed development, and this question leads to the market selection. Given that Thailand, Korea, Taiwan and others have attained high levels of electronics development, at which market should Vietnam aim? The electronics industry is also highly volatile, as seen by the recent IT recession. So our strategy must also be flexible. Could the Japanese experts suggest international experiences useful for Vietnam, especially the Malaysian experience?

Prof. Hoang Duc Than, *National Economic University*

Prof. Okamoto mentioned the problem of Vietnam's high costs. I do not think it is a major problem. Currently, the government is promoting decentralization so provinces can offer rent exemption, like the case of the Nomura Industrial Zone. According to the government's plans, the electricity tariff will come down and the telecom cost will be equivalent to the regional level by 2006. Second, the most important issue for the electronics industry is to increase the domestic content, to produce parts locally. The lesson from the motorbike industry is highly suggestive. The increase in local contents from 18% to 33% led to a large fall in the price. The IMF/World Bank study of Vietnamese production finds that the cost of imported inputs accounts for 42-60% while the labor cost is only 7-9%. Domestic production of inputs is very important. So can you tell us whether Vietnam should invest upstream for stable development or continue to do only assembling?

Mr. Nguyen Quy Son, *Vietnam Electronic Industries Association (VEIA)*

The government has no strategy for the electronics industry at present. We have clear targets for telecommunication and a plan has been submitted for software. But we have no strategy for electronics hardware. With the cooperation of the Vietnamese government and Japanese experts, I sincerely hope that a formal strategy will be drafted for hardware. As to the localization of parts, reality is moving faster than the government can think. To promote localization, tax incentives will be necessary. When AFTA tariffs begin to come down from 50% to 30% in 2003, there will be a severe problem of survival among TV producers. Technology must come from abroad, but we must upgrade infrastructure.

Prof. Okamoto

Thank you for your comments. I have visited many foreign electronics companies in Vietnam and they have a lot to say about high domestic contents requirement and high tariffs on imported components. In order to make them more competitive, they must procure cheaper inputs. There are two ways to do this. One is to import the best and cheapest parts from neighboring countries. The other is to attract FDI in parts. However, with the current production volume in Vietnam, it is very difficult to attract FDI in components that require large scale for efficiency.

In conclusion, I would like to make three remarks. First, Vietnam has a big potential in electronics, and whether that will be realized depends on policy. Second, as to the question of remaining in assembly or going upstream, let me say that the current global business model is concentrating on *core competence* and outsourcing the rest. And third, let me repeat that the government must have a good strategy for electronics to guide investors. At present, there is none.

SESSION 4 : TEXTILE AND GARMENT INDUSTRY

(March 29, 2002, afternoon)

Presentation by Prof. Nguyen Ke Tuan, National Economic University

With the comparative advantages of Vietnam, the textile and garment industry is very important in the national industrial structure. The CMT (:Cut-Make-Trim) mode is currently most suitable with Vietnam's textile and garment industry because of abundant labor, lack of capital and complicated technology, geographical location, etc. In the last few years, Vietnam's textile and garment production expanded considerably but the country still remains in a backward position. Exports also rose rapidly, reaching USD 2.15 billion in 2001, of which 70% was export processing. The CMT mode not only dominates, but also it is the main reason for foreign companies to choose Vietnam. The industry faces many constraints, including the limited access to foreign markets, weak competitiveness, and mismatches in institutional environment.

Despite these challenges, the industry's opportunities for development are great. The development strategy for the industry up to 2010 has been approved by the government, in which exports are targeted to USD 4 billion by 2005 and USD 7 billion by 2010. The BTA (:Bilateral Trade Agreement) with the United States has been ratified, giving the industry a chance to enter the American market in the future. We offer the following recommendations for textile and garment companies exporting through CMT.

- (1) Manage well the quality of material and accessories provided by foreign partners as well as the quality of each stage of production, improve the professionals and labor, and build and apply advanced quality management systems.
- (2) CMT partners should be diversified over different markets.
- (3) Promote investment for technological innovation.
- (4) Renovate production organization and management.
- (5) Follow the strategic direction of gradually shifting from CMT to FOB [The FOB, or free-on-board, mode refers to a production contract where the Vietnamese garment factory, not the foreign partner, procures inputs. It has no relation with FOB in international trade business].

On the government side, the main tasks are two: promoting investment in material development for the garment sector, and improving the legal environment.

Presentation by Mr. Kenta Goto and Prof. Yasuhiro Ota, *Kyoto University* and *Tokuyama University*

The textile and garment industry plays important roles in Vietnam. However, Vietnam is competitive only in the exports of a narrow range of garments and contributes to very limited stages of production and distribution. The main mode of garment production for export is CMT. This is suitable for Vietnamese garment manufacturers as it provides small risk and stable margins. Some factories export in the FOB mode, but even this is the simplest FOB (type I), not more advanced FOB (types II and III).

Our survey of factories and outlets in the North and South shows the lack of a modern merchandise distribution system. The Vietnamese textile markets are very primitive and cannot handle inter-firm business risks. If FOB is forced under such circumstances, each factory will have to bear all business risks and may end up losing money compared with CMT. This problem is more serious than the lack of modern production equipment.

The Vietnamese government has approved a “speed up” strategy for 2000-2010 aiming at (i) building a backward linkage through investment in the upstream sector (textiles); and (ii) early realization of garment export under “type III FOB.” However, we suggest that Vietnam should concentrate on the CMT mode for the moment, improving its quality and quantity and achieving its full potential.

After that, the next step will be the development of the upstream sector. But this should be supported indirectly, not by hasty investment but as a natural evolution of expanded garment production in the downstream. The upstream sector is highly capital intensive and requires high-level management and production skills. Its development takes time and money, and FDI should play an important role in it.

The following measures are additionally recommended: (1) clarify the causes of poor quality and low productivity and take appropriate measures; (2) expand the domestic market of ready-made clothes and materials; (3) encourage independent SMEs to link textile producers and garment makers (such SMEs already exist in HCMC (:Ho Chi Minh City)). The government should introduce measures to develop core competence and increase the availability of education, training and technical services.

Presentation by Prof. Yoshiaki Ueda, *University of Marketing and Distribution Sciences (UMDS)*

The leather and footwear industry has contributed to Vietnam’s economic growth. In 2001, it was the fourth largest export industry. The industry has a good prospect of future development, including the US market under the newly ratified US BTA. It has also

benefited from the policy of private sector development as well as low cost and high quality labor. However, Vietnam has to overcome a few obstacles: keen competition from other countries (especially China), high dependence on imported raw materials, etc. To strengthen the competitive edge, the government should integrate its industrial policies with the activities of enterprises in both global and domestic areas.

Seven policy actions are proposed: (1) set up “hybrid” vocational schools; (2) establish research and development centers for design; (3) receive foreign experts for technology transfer; (4) promote supply of low cost raw materials; (5) convert weak companies into other industries; (6) promote SMEs; and (7) promote exports for the entire industry.

Mr. Tran Manh Thu, *Ministry of Industry*

I was very interested in all the presentations. I have some comments. First, Prof. Tuan did not mention the quota issue for garment exports, but that is an important factor. Second, Mr. Goto advises indirect development of the upstream sector. Here I want more explanation. You are trying to demonstrate that the CMT mode has the comparative advantage in Vietnam today, and maybe you are correct. But the real question is how to get from here to more value-added: by promoting CMT or investing upstream? Can you, instead of describing advantages of CMT, prove that upstream investment is more costly for Vietnam than CMT in achieving this goal? China has a three-year strategy to upgrade textiles under WTO. Thailand is renewing technology. Technology changes fast, and we must find a short cut for development. I do not see why Vietnam should promote only CMT.

Mr. Truong Huynh Cam, *Vietnam Textile and Garment Corporation (VINATEX)*

We appreciate all of your presentations and agree with many of your points. Your assessment of CMT has been comprehensive. Of course we should aim at FOB as a long-term goal. VINATEX is also trying and some enterprises have reached high FOB ratios. To increase domestic content, the government has approved the 2000-2010 strategy. CMT has low risk but its productivity is low. It is prone to the same crises as FOB. Another important consideration is that the US market only accepts FOB exports. So CMT will not do.

As for the risk-sharing distribution mechanism mentioned by Prof. Ota, I think the Japanese model is not directly applicable to Vietnam. Regarding the quotas mentioned by Mr. Thu, garment exports depend on quotas only in EU and Canadian markets. To date, these quotas have been distributed to only garment manufacturers, not trading firms. So the Japanese experience may apply in future, but not today.

Vietnam has other difficulties, especially competition with Chinese exports. China has more material supplies than we do. Regarding FDI attraction, the current accumulation of FDI in the garment sector is relatively large, but the efficiency of these JVs (:Joint Venture) is still low. I wonder why. So attraction of FDI is good, but it may not be the highest priority.

Vietnamese participant

I agree with Prof. Tuan's recommendations, especially government actions to support education and management, provide stable legal environment, etc. I also concur with Prof. Ueda that the roles of government and enterprises should be more clearly separated. The government's role is to negotiate integration and draft a road map for guidance. This is extremely important in the current globalization trends. But all recommendations should be made more concrete.

Second, we should let the market decide how to go from CMT to FOB. We cannot deny FOB entirely since it is important and some markets require FOB. We should concentrate more on marketing and trade promotion.

Third, the suggestion to develop relations between producers and trading firms will encounter a problem in Vietnam. Currently, foreign sales are dominated by foreign companies which are profit-oriented. We need to diversify partnership.

Mr. Goto

We have discussed whether and how fast Vietnam should go upstream. This question is similar to that in electronics. As a current strategy, I believe Vietnam should focus on CMT, namely downstream, not upstream investment. I do not think "short cut" solutions are possible, and buying modern machines will not guarantee success. Vietnam can hardly afford the luxury of spending so much money on capital equipment.

However, this does not mean that Vietnam will forever remain at this level. Doing CMT well not only generates more value-added, but you will realize technology transfer through foreign partners and can move to the next stage.

Vietnamese participant

The government's roadmap for the textile and garment industry already exists. But it is certainly true that realizing full potential will take much time.

SESSION 5 : STEEL INDUSTRY

(March 30, 2002, morning)

Presentation by Prof. Nozomu Kawabata, Tohoku University

Our study discusses the policy options for the Vietnamese steel industry. The iron and steel industry includes many production processes. In Vietnam, the production structure is not only limited in scope but is also imbalanced. There are many rolling mills for long products, while there is too little steel-making capacity and no rolling mill for flat products.

The feasibility of constructing a large-scale ISW (:Integrated Steel Works) has been hotly debated among Vietnam's policy makers. In my opinion, however, the ISW is not an urgent problem. It is too large in capital requirement and cannot be built in a short time. Instead, the government should focus on the two immediate challenges that will determine the future of Vietnam's steel industry: (i) coping with the overcapacity in long product rolling; and (ii) successful operation of the nation's first flat steel mills.

First, with long products, steel-making capacity is lacking while rolling capacity is excessive. This resulted from mutually inconsistent trade and competition policies. The VSC (:Vietnam Steel Corporation) should avoid over-investment in rolling mills.

While Vietnam should liberalize its steel trade, its timing is important. I present two tariff reduction scenarios in concrete numbers and three policy options for your consideration. The first option gives top priority to liberalization. The second option makes partial modification to AFTA commitments for temporary protection of long products. The third option tries to strike a balance between temporal protection and the commitment of liberalization. In the first option, rolling mills will face difficulty because product margin for rolling mill will diminish rapidly. In the second option, relatively thick margin is predicted. In the third option, which combines strict AFTA implementation with slower liberalization with non-AFTA countries, the margin for rolling mill will be somewhere between the first two options.

Second, with flat products, the first CRM (:Cold Rolling Mill) will be built by 2003-04 to produce sheets. For viability of this mill, market research and development is crucial. The main target for the new flat products should be customers in the middle-range market. There is also an issue of speed of capacity expansion. If it expands too vigorously, it will create overcapacity in that market segment.

As in the case of long products, I have two tariff reduction scenarios and three policy options. If Vietnam adopts the first option (fastest liberalization), building a HSM (:Hot

Strip Mill) in the future will become virtually impossible because the margin is too thin. On the other hand, CRM and HSM can secure thick margins in the start-up periods in the second option (late liberalization). In the third option, the margin will be somewhere between the two options.

Overall, I recommend the step-by-step approach for developing the steel industry in Vietnam.

Pham Chi Cuong, Vice President, Vietnam Steel Corporation (VSC)

As for the past developments and current issues, Prof. Kawabata's observations are similar to mine. With respect to the overall speed of steel industry development, JICA cautions us since an ISW will require huge capital to build (\$5-7 billion) and face fierce competition. But some want an ISW as soon as possible. I agree with JICA experts that the step-by-step approach is superior. VSC's view is that Vietnam should not build an ISW early.

In building flat steel mills, we do not want to raise protection against Russia's cheap but low-quality sheets. These cheap products are needed in Vietnam. We will target other market segments to avoid direct competition with Russia.

As for boosting billet production, the pre-feasibility study of an EAF (Electric Arc Furnace) with a capacity of 500,000 tons was approved two days ago.

As for domestic raw materials, the pre F/S of Thach Khe ore is being conducted by the Russian team. After we receive its results, we will decide whether to proceed with the full F/S.

Regarding Thai Nguyen Steel Corporation, JICA advises us not to expand any further (second phase), but there are different views in Vietnam. My personal view is that Thai Nguyen should not be expanded any more; it is not competitive and cannot survive under AFTA due to import requirements and inappropriate location. Because of needed land transportation, its steel is \$10 higher per ton than other mills. Under AFTA, many mills must be closed or consolidated, and only those with good technology will survive.

Presentation by Prof. Hoang Duc Than, National Economic University

The steel industry has an important role in Vietnam's industrialization. Since 1986, it has been performing well in terms of capacity and product diversification. However, the industry also faces some drawbacks: the monotonous and simple product structure (only low and medium quality long products); the low capacity of billet production; out-of-date technology; and inconsistency between targets and capacity. Competitiveness is weak with

respect to production cost, human resources and infrastructure. The regional and international integration process has posed many challenges for the steel industry, and the survival of enterprises operating in Vietnam is being threatened. We have the following suggestions to reform the industry in the integration process.

Regarding the government policy, various resources should be mobilized including budget, ODA (:Official Development Assistance) and FDI to train staff, build infrastructure and promote R&D. These indirect measures are better than directly subsidizing steel enterprises. The protection policy should be reasonable with proper selection of products based on the situation of the domestic market and AFTA commitments.

Regarding enterprise efforts, competitiveness comes from cost advantage as well as differentiation. Production cost can be reduced by organization, technology and the efficiency in input use. We propose the scheme for cutting cost in the medium and long run as described in the table in our paper. Product differentiation requires enterprises to reform distribution to create more value for customers. We have concrete data for the profitability of state-owned steel distributors in the paper. VSC should reorganize its structure and activities, and the steel association should play more roles.

Dr. Do Huu Hao, *Director General, Institute of Industrial Policy and Strategy*

All presentations have described the steel industry well and given good recommendations for our policy design. I have the following comments. Our steel industry is imbalanced. Although there is overcapacity in rolling, more manufacturers are entering into this market. The VSC and MPI (:the Ministry of Planning and Investment) must curb investment in steel rolling.

There are two opposing views on the development of the steel industry: go upstream fast, or step-by-step. The government takes the second position. As to Thai Nguyen, we are only talking about expansion to the maximum capacity of 0.5 million tons of billet, and not more. Quy xa ore is inefficient. The new investments should be on the coastal area, near Ha Tinh ores. We will use gas for billet production.

We are facing many challenges, especially the difficulty in capital mobilization. Soft loans with 3% interest rate are available but amounts are limited. ODA loans are no longer usable for steel. Please also note that domestic steel demand is rising strongly. CRM and HSM must be built soon.

Mrs. Nguyen Thi Bich, *Deputy Director, International Relations, Ministry of Finance*

We highly appreciate all presentations; they have provided valuable information and mentioned issues of our interests. Regarding policy options offered by Prof. Kawabata, I have some questions. First, you have proposed scenarios for tariff reduction in the steel sector. In my opinion, AFTA commitments are fixed and should not be changed. If we want to renegotiate the AFTA commitments, we have to offer new concessions in other products. Is such a strategy profitable for the whole economy? And if we choose to renegotiate, what should be the proper length of protection for the steel industry? Second, in your tables you start the projections from the 20% tariffs, but the current AFTA tariffs for steel are already less than 20% [Note: there is however a dispute as to whether that has really been implemented]. Third, Prof. Kawabata mentioned Russia and Ukraine as big competitors, but what about neighboring countries like Thailand and China? I fear they will be even bigger competitors for Vietnam.

Prof. Ohno

Concerning the renegotiation of AFTA commitments, I think that the message conveyed by Prof. Kawabata is that it should not be renegotiated. His third policy option, which is most reasonable, combines full AFTA implementation with temporary higher tariffs against non-AFTA countries. This avoids the political mess associated with AFTA renegotiation.

The grave problem with Vietnam's industrial policy is that it is not integrated with trade policy. In the opinion of the ministries responsible for international integration, free trade commitments should be surely honored. But from the viewpoint of building industrial strength, part of the Vietnamese government still considers deviation from AFTA as a serious option. And investors, both domestic and international, are perplexed as to which policy will be followed in each industry.

Another problem with AFTA is that it is not certain whether other members like Indonesia and Malaysia will fully implement AFTA. Particularly in steel, with globally depressed prices and US anti-dumping disputes, it is very unlikely that AFTA will proceed as scheduled. If so, we cannot expect Vietnam to stick to AFTA when most other members are not implementing it, at least in steel.

Prof. Kawabata

Thank you for your questions and comments. My second policy of postponing AFTA commitments is only one option among many, for the Vietnamese government to consider and choose from. Personally, I do not recommend it to you. But the reality of the steel

industry is such that, as Prof. Ohno noted, not only Vietnam but other ASEAN countries face difficulty in keeping the AFTA deadlines. Thailand imposed a 25% surcharge on flat steel this January, on top of the 10% tariff. Malaysia is doing the same. My prediction is that ASEAN as a whole will be forced to renegotiate tariff reduction in steel products.

But apart from this, if Vietnam decides to respect the AFTA commitments, I believe the third option is most realistic. Differential tariffs between ASEAN and non-ASEAN does not violate the non-discrimination principle of WTO, since AFTA is considered to be regional integration.

On the question of Asian rivals, I have checked their potentiality already. My overall conclusion is that neighboring countries are not the largest threat to Vietnam's steel makers. In long products, ASEAN producers are not competitive at all. In flat products, producers in Thailand are competitive, especially Japanese affiliated cold rolling mills. They tried to export during the Asian crisis, but they supply domestically under more normal circumstances. Russian and Ukrainian producers are serious rivals, so relatively high tariffs should be imposed on their exports. China is a big steel producer but does not export much. But by 2010, this situation may change.

SESSION 6 : SOFTWARE INDUSTRY

(March 30, 2002, morning)

Presentation by Dr. Truong Dinh Chien, *National Economic University*

The Vietnamese software industry is new, with about 200 enterprises operating in the market. The domestic market is also new with low demand. The product structure is simple and monotonous. On the export side, Vietnam's access to international market is limited; only a few companies export to a limited number of countries. Total export value is USD 5 million, or 5% of the industry's total revenue. The industry's competitiveness is weak and the production scale is small.

Despite these points, the industry has a good potential in terms of human resources, low labor costs and government support. Considering all the strengths, weaknesses, opportunities and threats, we would like to propose the following development strategy. By the year 2005, the software industry should attain the domestic sales of USD 80-90 million and the export revenue of USD 200 million. The attraction of FDI and enhancement of the reputation of Vietnam's software industry are also important targets. To achieve these goals, we need to carry out a set of comprehensive measures. These include implementing a mixed marketing strategy, improving supporting policies like training of human resources, developing domestic and international markets, building good IT infrastructure and improving the legal environment.

Mr. Nguyen Quy Son, *Vietnam Electronic Industries Association (VEIA)*

Your presentation has covered almost all issues in Vietnam's software industry. We greatly appreciate recommendations in your presentation and will use some of them in developing the program for the software industry in the period 2001-2005. However, it would be better if you concentrate on fewer issues and provide deeper analysis. In my opinion, the software industry in Vietnam has a good potential to develop. However, to find suitable promotion steps, an appropriate strategy is needed. The Vietnam's software products are facing many obstacles, including the lack of English capability and low commercial value. The NEU study has suggested many measures, and we hope JICA will assist us to concretize major ones.

Mr. Nguyen Huu Thang, *Vietnam Electronic Industries Association (VEIA)*

This is a complete study with appropriate approaches. The study has provided many valuable findings that even industry insiders could not recognize. The first part of the study has provided us with a comprehensive assessment of the industry's current status. Regarding the domestic market of software, I think it is growing strongly, with rising demand for internet and telecommunication, the e-government program worth VND 1000billion, the Edunet program worth USD 450 million, etc. In my opinion, we also need to analyze the software industry in close relation with the hardware industry.

However, I wonder if your forecast of exports of USD 200 million is based on sound ground.

The study mentions many good strategies. I want to add that we need to focus on a few crucial products to design appropriate exporting policies. The idea of software parks remains unclear. The current policies are good in general terms, but we need concrete measures to implement these policies.

Mr. Long, *Information Technology Center, Vietnam Bank for Agriculture and Rural Development*

Let me say a few things as a user of software. I find the NEU study reasonable with high practicability. But we need to set clear goals and orientations, including targeted markets. Concrete measures should include good training for software writers. At our center, it takes two years to train new staff for our own programs, and five years to work efficiently in the banking sector. The software industry lacks consultants, managers and other well-trained professionals. The client-provider relationship, which is less than ideal, must be improved. Public awareness campaign is also needed, as some top managers do not have enough knowledge about computer software.

Mr. Huynh Duc Thang, *Ministry of Planning and Investment*

The study is comprehensive and logically presented. I have some comments. First, in assessing the strengths and weaknesses of the sector, you are relying on the general perception like the Vietnamese are intelligent, but more training is necessary, etc. This is not concrete enough. As to training, for example, the question is where we should start. Software writers need a few more years of training, it is said, but who will teach them? And where are the curriculums? We need deeper studies on these two issues of teachers and methodology. Second, regarding the telecom sector, I do not think slow speed is a problem. The reason why the Quang Trung IT Park does not function well is not related to the

problem of infrastructure. Its failure is due to high service cost and inherent localism of the Vietnamese people. Each ministry and province wants to have its own IT department and programs, causing dispersion of limited resources. This issue should be taken up in the policy formulation process.

Prof. Ohno

I would like to question if the NEU's export target is really realistic. Vietnam's software is a baby industry with very limited capabilities. The paper presenter proposed two development directions: domestic sales and international marketing. But I think Vietnam should concentrate on the domestic market, which is growing fast and also protected by the language barrier. The international market is very hard to penetrate for such an infant industry with low English proficiency. Separately, I was surprised to hear that local fights over IT industries are so fierce in Vietnam. Do Hanoi and HCMC fight to have their own IT parks and projects?

Mr. Alain Chevalier, *Senior Technical Advisor, VIETRADE, Ministry of Trade*

I agree with Prof. Ohno that in Vietnam, we need to focus on the domestic market. I note that the present export value of the industry is only USD 3 million, and as targeted, it should reach USD 200 million by 2005. This is impossible. However, the potential for Vietnam's software industry is good, especially with respect to speed of growth. The computer literacy of the young Vietnamese is picking up quickly. Internet is still slow, but it takes time to improve the infrastructure. Many talk about e-commerce, but Vietnam should do other things first, including upgrading of the contents of web sites.

I would like to emphasize the importance of marketing. Production must follow the market, not vice versa. This is true for both domestic and foreign markets. Government should help those who help themselves. Let government follow and support them. Instead of big targets for the whole industry, there should be an accumulation of concrete strategies, each not too ambitious, to improve "how to" capabilities. To improve the image of Vietnamese software, what is needed is action. Regarding human resources, exporting programmers is not a good idea because they will not come back! At any rate, there are very few Vietnamese software companies abroad. My final point is that we should look at ASEAN experience and draw lessons for Vietnam.

Mr. Pham Hong Chuong, *National Economic University*

Let me comment on and review the arguments of the last two days. First, whether upstream or downstream, we should focus on the stages of production where Vietnam has efficiency and comparative advantage. We are in the globalization age, and risk is acceptable and necessary in order to become part of the international production network. However, not everything is acceptable. Second, we should shift from the production-oriented planning method with quantitative targets to the market-driven approach where production is for the sake of the satisfaction of users.

Regarding software, Vietnam need not have a complete software industry. Let us focus on applications if that is our comparative advantage. If that succeeds, we can move to network software with greater labor skills and capital later. If we want to export, we must find a market niche.

Dr. Do Huu Hao, *Director General, Institute of Industrial Policy and Strategy*

There are four points we should consider seriously for the Vietnamese software industry. First, we need to pay more attention to the copyright issue. Second, the salary of software engineers is too low which is causing brain drain. The industry is too small and weak to offer high salaries to attract good people. Third, there is a supply imbalance: we have a lot of application and accounting software but very few industrial applications. And finally, we need to have a training strategy. We should establish special schools for IT skills. Education of young Vietnamese is needed with assistance of foreign experts. India provides a good example for Vietnam.

Mr. Vu Huy Thong, *National Economic University*

Thank you for all of your comments and suggestions, especially the opinions about IT education. This issue draws much attention from the government as well as the industry. Regarding the telecom environment in Vietnam, I think the slow speed of internet access is a problem for the software companies. Also, I agree with Dr.Hao on the issue of the copyright. It is the responsibility of the government to solve this problem. If this project continues into the third stage, we should focus on the IT education issue.

CLOSING SESSION

Prof. Ohno

After two days of lively discussion, I want to say three things in summary.

First, the common thread of our debate across many industries was how to increase the value-added of the Vietnamese industry. Right now, Vietnam performs only a small link in the production process, and the rest is done by foreigners. The two conflicting considerations always come up: (i) in the age of globalization Vietnam must accept free trade and take advantage of FDI dynamics as much as possible; and (ii) Vietnam should take a strong initiative in national industrialization, not just passively receiving foreign influences. These two ideas must be combined wisely and realistically.

Second, from now on, all studies must go into much greater detail, proposing policies that are concrete and operational. This is also what we wish to do in the third stage.

Third, to discuss each industry more deeply, we should have smaller and more targeted seminars with relevant government officials and enterprise managers.

Closing remark by:

Prof. Nguyen Dinh Phan, *Vice rector, National Economic University*