Deutsches Institut für Entwicklungspolitik
German Development Institute

Industrial Policy in Vietnam

Workshop „Industrial Policy in Developing Countries“

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1. **Historical and political background**
2. **Vietnam‘s industrial policy**
3. **Conclusions and policy recommendations**

1.

Background:

Big progress towards system transformation

Background

Steps in the transition towards the Socialist Market Economy

- Socialist history, no opportunity for private sector development until end 1980s. Economy then almost bankrupt, demise of COMECON
- 1986 Doi Moi, initiated gradual liberalisation: Role model China: Market economy with SOE.
- After 1993-95, rapid growth of FDI
- First enterprise law 2000: easy entry for new firms
- Second enterprise law 2005: level playing field for all firms
- 2007 WTO accession
- Financial sector opened to competition. Share of loans going to the private sector went up from 37% (1994) to 70% (2006)

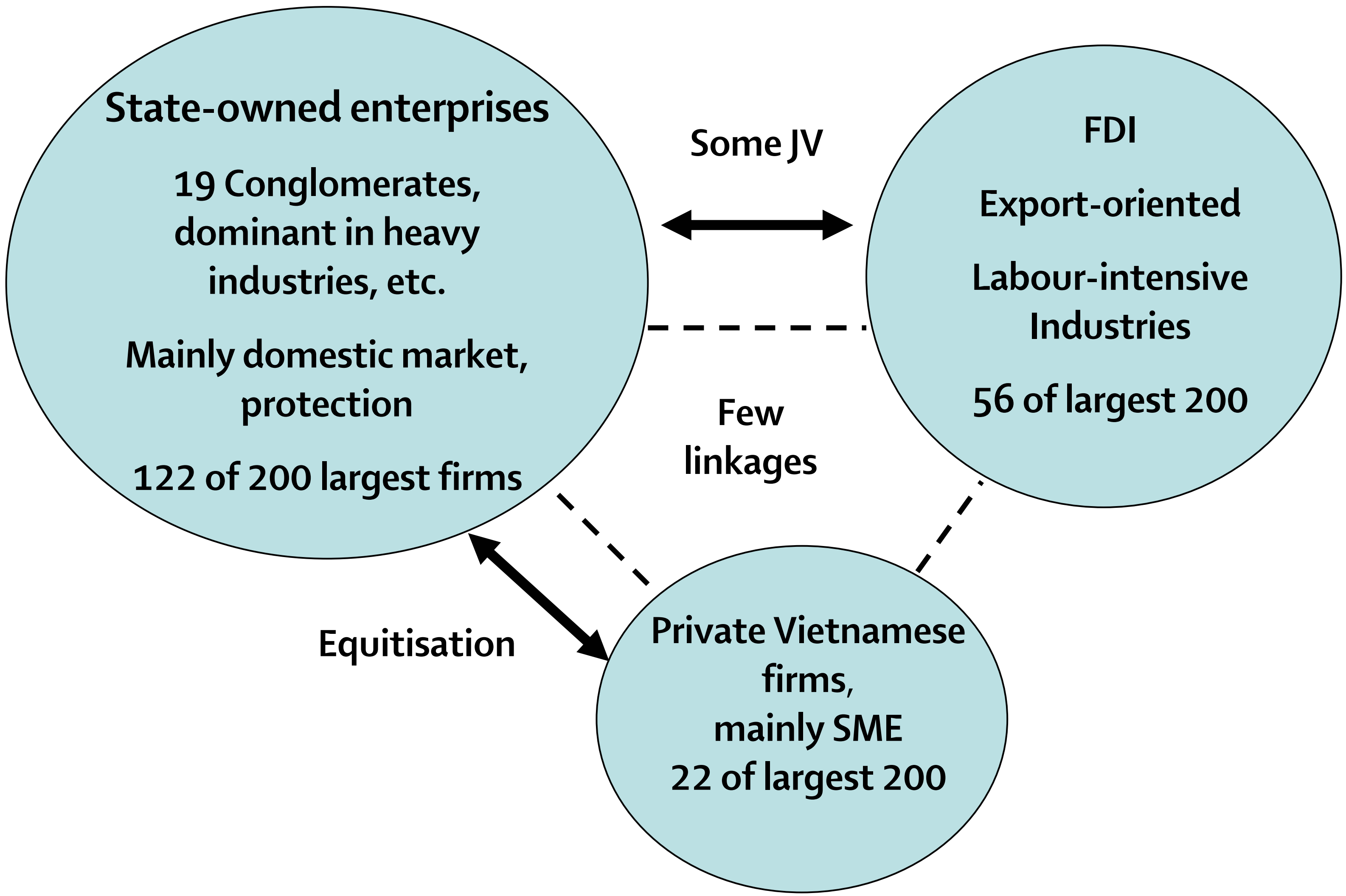
Background

Creation of a multi-ownership economy

- Initially, manufacturing sector completely state-owned. Focus on heavy industries, targeted at domestic market, protection
- Following liberalisation of FDI in 1993, FDI picks up in labour-intensive manufacturing for export (garments, footwear)
- Following the new Enterprise Law in 2000, private Vietnamese enterprise mushroom

⇒ **Today: three-polar firm structure**

Background


State-owned enterprises
19 Conglomerates, dominant in heavy industries, etc.
Mainly domestic market, protection
122 of 200 largest firms
Some JV
FDI
Export-oriented
Labour-intensive Industries
56 of largest 200
Few linkages
Equitisation
Private Vietnamese firms, mainly SME
22 of largest 200

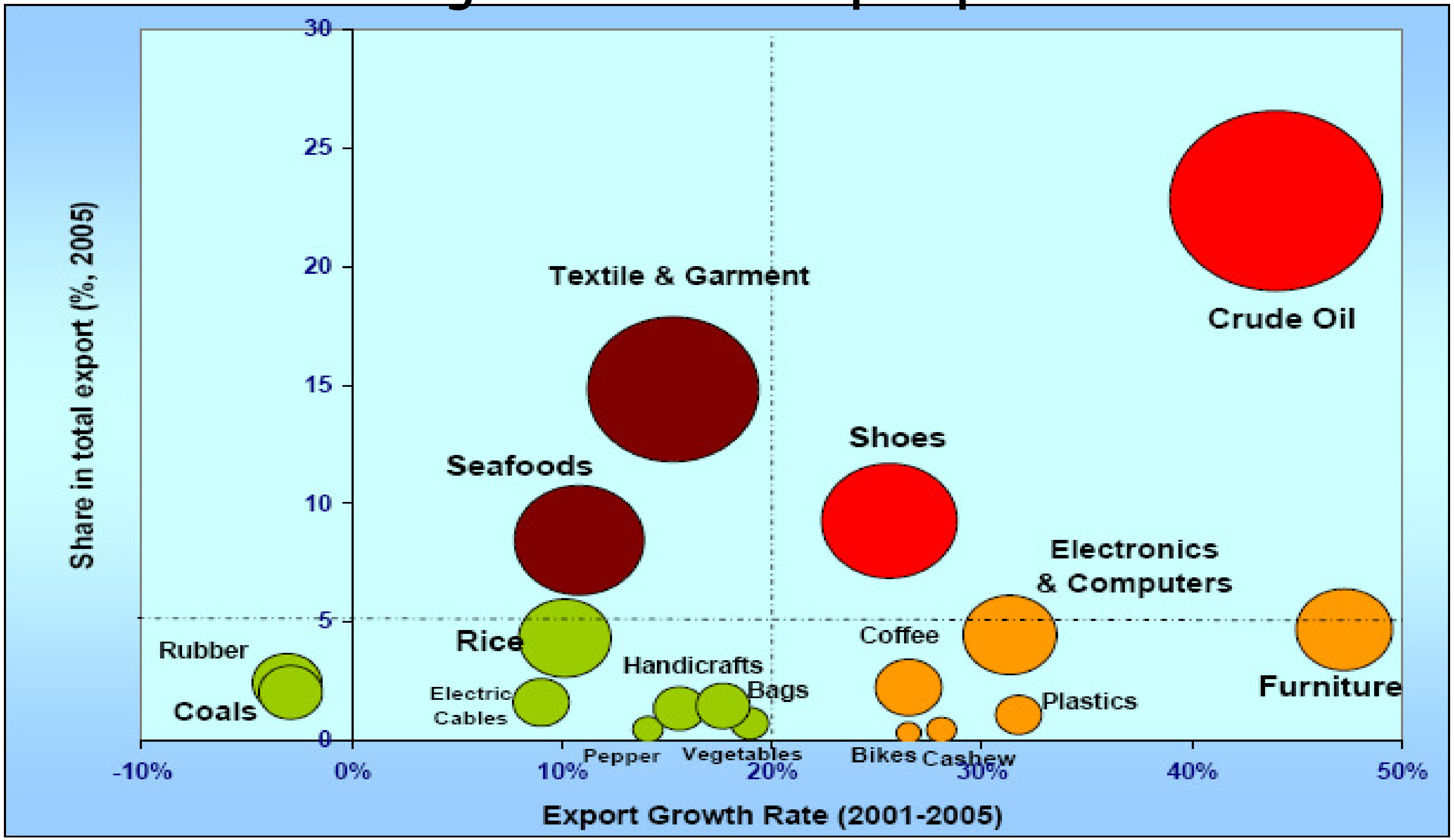
Background

Successful global integration

- High economic growth (around 8% p.a. over the last years. 2008 still 6.2%)
- Industrial VA grew even faster: 10.9 % p.a. btw 1990 and 2005
- One of the most open economies of the world. Exports = 75% of GDP
- Among the largest exporters of rice, coffee, shrimps. Third largest ship-building industry ...
- FDI inflows recently larger than China's, relative to market size.

Background

Vietnam: Share and growth rates of export products



Dwight Perkins/ Vu Thanh Tu Anh (2009).

Historical background

- At the same time: Still heavily regulated; financial sector dominated by State banks; high level of corruption

⇒ How can a socialist economy, led by a Communist Party and dominated by protected SOEs, be so successful?

⇒ To what extent has this been due to proactive industrial policies?

2.

Vietnam‘s industrial policy

Vietnam's industrial policy

Liberalisation and WTO accession

- After severe crisis in 1980s, strong conviction to build on mixed economy and competition.
- WTO accession in 2007 changes rules for industrial policy:
- Before: Export subsidies, tariff and non-tariff barriers to trade, compulsory localisation, credit subsidies …
- Now: Focus on supply-side support

Vietnam's industrial policy

Policies for SOE

- WTO accession threatens SOE in particular
- „Equitisation"= transform SOE in shareholding companies in which State retains important shares, mostly with additional shares held by private investors and managers/workers.
- Out of 6,000 SOE, 3,000 „equitised" – mostly small ones.
- Strategic firms remain with 100% state ownership. On average, 70% state shares.
- Goal to finalise equitisation by 2010 will not be achieved.
- SOE sector still 34% of industrial value added.

Vietnam‘s industrial policy

Policies for SOE (2)

- Performance worse that FDI and private enterprises, > ¼ making losses
- In the past, heavily subsidised: allocation of valuable land, infrastructure investments, tax exemption, subsidised loans, no collateral requirements, debt rescheduling, state budget allocations, public contracts without bids etc.
- Policy goal: Full equitisation, increased competititon, reduce privileges of equitised firms.

Vietnam's industrial policy

Policies for SOE (3)

- New strategy: Create 19 conglomerates by merging smaller SOEs
- On basis of political decisions (PM based on proposals by line ministries) – not enterprise-driven via M&A. GM appointed by PM, BoD consists of representatives from ministries
- Conglomerates allowed to gain controlling interests in banks. („keiretsu model")
- Contradictory messages: Desire to maintain leading role of state-owned sector ***versus*** commitment to increasing competition and PS as driver of growth.

Risks: *Moral hazard: too big and politically influential to fail?*

Unfair competition: 40% of SOE investment in areas outside core competence, e.g. real estate

Vietnam's industrial policy

Policies for SOE (4)

- **Official justification** for *maintaining state ownership*: avoid private monopolies („avoid Russian experience")
- Justification for *creating conglomerates*: Increasing economies of scale, allowing them to purchase big quantities, create national brands etc. („follow Korean experience")
- **Inofficial reasons (?)**
- Maintain power base of Communist Party? (control of SOE provides opportunities for handing out non-material privileges, e.g. to party and union members)
- Rent-seeking by state entrepreneurial class?
- Disguised protection: Use subsidised credit, local content requirements etc. within the boundaries of the conglomerates?

Vietnam's industrial policy

Policies for SOE (5)

- **Trade-off:** CPV needs economic success for **legitimisation** – this was the reason for Doi Moi … credible roadmaps wrt equitisation, opening up of energy sector …
- … and needs SOE as the **power basis**.

⇒ Delicate balance btw state control and market-based competititon

Policies for FDI (1)

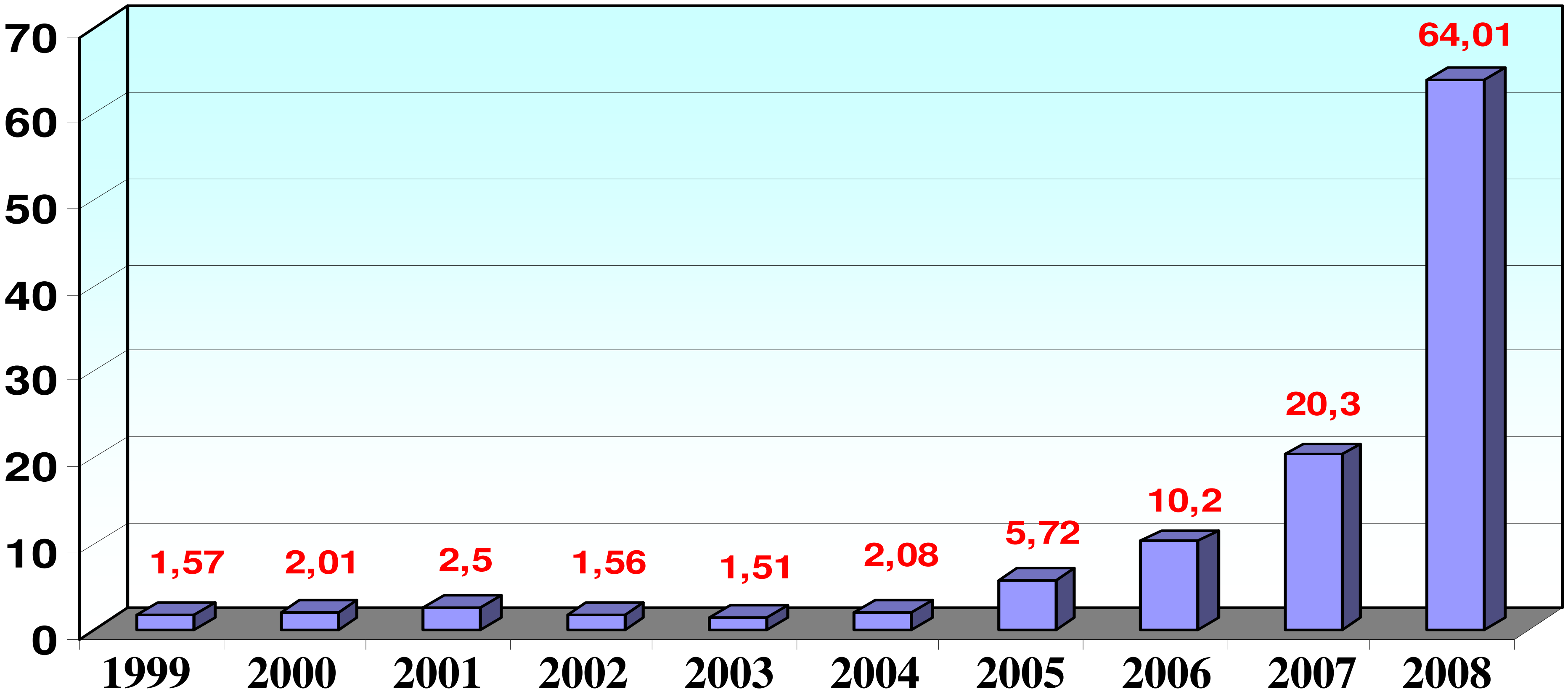
Special Economic Zones since 1991 (EPZ, IZ …)

Tax holidays and other privileges – to be reduced after WTO accession

End of export subsidies

But WTO accession greatly increased attractiveness for FDI

Commited FDI into Vietnam from 1999 to 2008



Source: Foreign Investment Agency, Ministry of Planning & Investment (modified)

Vietnam‘s industrial policy

Policies for FDI (2)

HCMC: EPZ now only for high value products, no more garment

Two Hi-Tech Parks to attract knowledge-intensive FDI, integrated concept incl. university linkages etc.; limited success as of now

Vietnam‘s industrial policy

Policies for FDI (3)

Licensing & localisation strategies: Automobile industry:

- Licenses for 11 carmakers
- Localisation policy to encourage local content
- Unlikely to succeed (economies of scale, too many factories, supply-side constraints)

Motorbike industry:

- Low-tech, large market. Successful localisation, industry gaining regional market share

Vietnam's industrial policy

Policies for local enterprises

Enterprise lawx 2000 and 2005 levelled playing field …

… but still considerable disadvantages vs. SOE and FDI.

WTO accession helps to create level playing field vs. FDI, but doubts about disguise subsdies for SOE/ equitised firms.

Very little support for fully private firms, e.g. neglect of active supplier development, technlogy transfer policies

3.

Conclusions and policy recommendations

Conclusions and policy recommendations

In terms of industrial transformation and growth, Vietnam is the most successful country of our sample.

Much of the success is *independent* of industrial policy

- Benefited from proximity to China. Growth spillovers, e.g. „China + 1“ strategy of foreign investors to spread risk
- Location on the trading route from China to Europe
- Natural resources: oil, tourism …
- Factor cost advantages and hard working people

⇒ Allowing for private entrepreneurship and FDI created strong response

Conclusions and policy recommendations

Selective industrial policies ….

…. have contributed to success in some cases:

- FDI: Flexible, elements of an upgrading strategy (take away subsidies for garments, Hi-Tech Parks)
- Research and extension services helped to expand coffee, seafood industry, cashew …
- Successful localisation of motorbyke. Development of local suppliers

Conclusions and policy recommendations

… have failed in other cases

- Creation of national autoparts industry failed
- Steel industry largely failed

Formation of SOE conglomerates involves considerable economic and political risks

Conclusions and policy recommendations

Three main challenges ahead:

1. Challenge: Transition from the „easy“ phase of factor-driven export-led growth to knowledge-driven: Export diversification, functional upgrading, supplier upgrading …
    - Provide incentives foor private entrepreneurs to diversify / innovate, support spontaneously emerging activities rather than policy-driven grand projects (e.g. to build up shipbuilding industry, textiel industry)
    - Voluntary supply-side measures for localisation (e.g. via partnership with FDI)
    - (higher) education and TVET big constraint
2. Establish level playing field for all firms, stop subsidising inefficient SOE
3. Improve policy process: Weed out unneccessary bureaucratic procedures, control corruption, evaluate policies systematically and independently, strengthen checks & balances. Important to let