FOREIGN DIRECT INVESTMENT IN VIETNAM: THE CASE OF THE AUTOMOBILE INDUSTRY

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ABSTRACT

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After years of high growth rate, Vietnam's economy has the sign of slowdown and been uncompetitive. The threats of being lagged far behind regional countries are available. It is due to chronical weaknesses of Vietnam's economic structure and (socialist factors of economy), as well as current government policies. Foreign direct investment (FDI) is an important external capital resource for development of Vietnam, but inappropriate policies prevent the effective utilization of FDI. Vietnamese automobile industry, fostered by private FDI, is example of uncompetitive industry.

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ABBREVIATIONS

ADB ---------- Asian Development Bank
AFTA ---------- ASEAN Free Trade Area
AICO ---------- ASEAN Industrial Cooperation
AIJV ---------- ASEAN Industrial Joint Venture
ASEAN ---------- Association of South East Asian Nations
BBC ---------- Brand-to-Brand Complementation
BIT ---------- Bilateral Investment Treaty
CBU ---------- Completely Built-Up
CEPT ---------- Common Effective Preferential Tariff
CKD ---------- Complete Knock-Down
DDT ---------- Treaties for the Avoidance of Double Taxation
ERP ---------- Effective Rate of Protection
FDI ---------- Foreign Direct Investment
FOE ---------- Foreign Owned Enterprise
GATT ---------- General Agreement on Tariffs and Trade
GDP ---------- Gross Domestic Product
HDI ---------- Human Development Index
ICOR ---------- Incremental Capital Output Ratio
IMF ---------- International Monetary Fund
JV ---------- Joint Venture
LDC ---------- Less Developed Country
MIGA ---------- Multilateral Investment Guarantee Agency
MNC ---------- Multi-national Corporation
SKD ---------- Semi-Knock-Down
SOE ---------- State-Owned Enterprise
TNC ---------- Trans-national Company
TRIM ---------- Trade Related Investment Measures
TRIPS ----------Trade Related Aspects of Intellectual Property Rights
VAMA ---------- Vietnam Auto Maker Association
VAT ----------Value Added Tax
VMC ---------- Vietnam Motor Corporation
WB ---------- World Bank
WIPO ---------- World Intellectual Property Organization
WTO ---------- World Trade Organization

Chapter 1

INTRODUCTION

Foreign Direct Investment (FDI) has soared in importance over the past decade as a source of capital, management, and technology for the developing world and economies in transition. However, with a perspective toward FDI that highlights the possibility of substantial dangers as well as substantial opportunities. FDI may have positive or negative impact on development, it is caused by well or ill-structured projects, but mainly by competitiveness of the host-country markets, which in turn are often influenced by host-country policy.

The *Doimoi* (renovation policy) of Vietnam, which introduced market-oriented reforms to the economy, has accelerated the country's progress towards industrialization and integration into regional and global markets, accompanied by the positive role of FDI. After a decade of economic growth at high rate, Vietnam's economy has the sight of slowing down. Vietnam is one of the poorest nation in the world, and FDI inflow is the important supplemented source of development investment for the country. However FDI has not only positive impacts but also negative impacts on the host country's economy. The main role that can be played is the host government policies towards FDI, accompanying with the trade and industrial policies of the country.

The purpose of my thesis is to review successes and failures of FDI in Vietnam since the Doimoi was introduced in 1986, and then to analyze a particular industry – Vietnam's automobile industry - which has attracted a huge amount of FDI inflow from trans-national companies (TNCs). The aim of the analysis is to examine the Vietnamese policies currently employed to shape FDI environment. Before 1986, Vietnam had no an automobile industry, except some repair works. Since the Law on FDI was introduced in

1987, many auto makers rushed to Vietnam to set up their automobile production facilities. More than 10 years passed since the first auto maker came to Vietnam, it seems that non of the targets set either by the host country government or by investors has been achieved so far. The achievements in the automobile industry has been modest, it has even had negative impacts on the whole economy. Is this a case of policies failure? My paper tries to make an assessment on the effectiveness of the automobile industry in Vietnam.

With an ambition to build its own automobile industry, adopting experiences from the North and South East Asian countries, who have succeeded in this industry, Vietnamese government decided to protect this infant industry by the policy, which, as by some specialists, imposes high costs on other sectors of economy. These policies are named as picking winner, performance requirement, capital-intensive import-substitution policy…

The concern of the paper is that whether these protective policies are appropriate or not for Vietnam? Does government need to abolish them toward more trade liberalization or to continue the protection by employing adjusted policies? Which of the policies should be implemented instead to push the national auto industry develop? The paper tries to answer these questions in light of new arguments of economic development in the changing context of the world economic environment.

The methodology used in this paper is the case study on specific industry within one country. This industry was born with the inflow of FDI into Vietnam, therefore the industry will be observed in the context of overall FDI picture in the country. Time series data and cross section data of the vehicle manufacturing operations will be collected, the production results will be observed. The costs and benefits gained by the host country will be weighed to evaluate the effectiveness of the industry.

The remainder of the paper is structured as follows. In chapter two, we review the role of FDI in economic development in developing countries, and several protective policies affecting the national economy. In chapter three, the successes and failures of FDI in Vietnam will be mentioned. Chapter four looks into details of the Vietnamese automobile industry to assess how the host government policy can affect the performance of the industry. In the last chapter we will summarize the key findings and give some possible recommendations.

Chapter 2

LITERATURE REVIEW ON FOREIGN DIRECT INVESTMENT

The challenge of utilizing FDI as part of the development process is much more complicated than conventional wisdom suggests. The direct and indirect benefits from well-constructed FDI projects are substantially greater than commonly assumed, but they do not come easily. To capture the full advantages that international investors have to offer requires a much broader and more energetic agenda than developing countries and economies in transition have been accustomed to pursue. This chapter will discuss the role of FDI on host-country development and the impacts of host country policies on shaping FDI for the economic growth objectives.

I. The Role of FDI in Economic Development

To a greater or lesser degree, most of the world's countries are now pragmatic nationalists with regard to FDI. For these countries, the main issue is to weigh the relative benefits against the costs of FDI. Economists who favor the free market view argue that the benefits of FDI to a host country outweigh the costs[1]. Let us review the benefits and costs of FDI.

The Benefits of FDI

FDI brings a complementary source of investment to host countries and other benefits, namely resource-transfer effects, employment effects and balance-of-payment effects.

FDI as a complementary source of investment: Investment is a key factor in economic growth. Practically all empirical studies of inter-country differences in growth rates

[1] Hood and Young, *Economics of the Multinational Enterprise*

suggest that high growth is associate with high investment rates. Recent endogenous growth theories also reinforce the link between investment and growth[2]. They postulate that, when investment is taken in a broad sense, to include not only expenditures on capital goods but also endogenous on technology enhancement and human capital formation, there may well not exist diminishing returns to investment. Therefore, country that devote a high proportion of output to investment may sustain more rapid growth than countries that invest less. Investment, today as much as yesterday, remains crucial to growth (p.157 WIR1999).

In close economy, with no access to foreign savings, investment is financed solely from domestic savings. In open economy, foreign savings play a complementary role in the provision of financial resources for development. They permit domestic investment in a country to exceed its own savings. A recent study of the impact of FDI on economic growth, utilizing data on FDI flows from developed countries to developing countries on a yearly basis from 1970 to 1989, has found, among others, that FDI has stimulated domestic investment: "a one dollar increase in the net inflow of FDI is associated with an increase in total investment in the host economy of more than one dollar. The value of the point estimates place the total increase in investment at between 1.5 and 2.3 times the increase in the flow of FDI[3].

Among foreign savings (international portfolio, bank lending, ODA and FDI), FDI plays an growing important role. FDI has been one of the defining features of the world economy over the past two decades. It has growed at an unprecedented pace for more than decade, with only a slight interruption during the recession of the early 1990s. More firms, more industries from more countries are expending abroad through direct investment than

[2] For a review of the literature, see Barro and Sala-I-Martin, 1995.

ever before, and virtually all economies now compete to attract multinational companies (MNCs). As a result, global flows reached an historic high of US$644 billion in 1998, FDI inward stock amounts to US$4,088 billion.

The ratio of FDI inflows to gross fixed capital formation in country is a good criteria to show the increasing impact of FDI to economic growth.

Table 2.1 The ratio of FDI inflows to gross fixed capital formation, annual average, by region, percentage.

	World	Developing countries	South, East and South-East Asia
1971-1980	2.4	2.1	2.1
1981-1990	3.75	3.7	3.5
1991-1997	5.0	7.0	7.45
1998	7.7	10.3	9.1

Source: UNCTAD, TNC/FDI data base.

Resource-transfer effects: FDI supplies not only capital, but also technology and management resources to host country. The crucial role played by technological process in economic growth is now widely accepted[4]. Technology is a catalyst that can stimulate economic development and industrialization. Management skills are important benefits for the host country. Beneficial spin-off effects arise when local personnel who are trained to occupy managerial, financial, and technical posts in the subsidiary of a foreign TNCs subsequently leave the firm and help to establish indigenous firms.

Employment effects: FDI brings jobs to a host country that would otherwise not be created there. Employment effects are both direct and indirect. Direct effects arise when a foreign TNC directly employs a number of host country citizens. Indirect effects arise when

[3] Borensztein, *et la*., 1995, p.3
[4] P. M. Romer, "The Origin of Endogenous growth", Journal of Economic Perspectives 8, no. 1 (1994), pp.3-22 ~~(1994), pp.3-22~~

jobs are created in a local suppliers as a result of the investment and when jobs are created because of the increased spending in the local economy resulting from employees of the TNC. The indirect employment effects are often as large as, if not larger than, the direct effects. In the case for example, we saw that Nissan's investment in the U.K. created 4,250 direct jobs and at least another 4,000 jobs in support industries.

Balance-of-payments effects are important policy issues for most host governments. Balance-of-payment accounts are divided into two main sections: the current account and the capital account. There are three potential consequences of FDI: (i) When an TNC establishes a foreign subsidiary, the capital account of host country benefits from the initial capital inflow. (ii) If the FDI is a substitute for imports of goods or services, the effect can be to improve the current account of the host country's balance of payments. (iii) When the TNC uses a foreign subsidiary to export goods and services to other countries, the host country's balance-of-payments benefit. In opening case of Nissan in the U.K., the benefit to Britain's balance of payment was that Nissan exported up to 80% of the automobiles assembled at its Sunderland plant.

The Costs of FDI

FDI can also have a number of negative effects on host country's economic development. Although FDI provide capital, they may lower domestic savings and investment rates by shifling competition through exclusive production agreements with host governments, inhibiting the expansion of indigenous firms that might supply them with intermediate products by instead importing these goods from overseas affiliates, and imposing high interest costs on capital borrowed by host governments. Although the initial impact of FDI is to improve the foreign-earnings position of the recipient nation, its long-run impact may be to

reduce foreign exchange-earnings on both current accounts (as a result of substantial importation of capital and intermediate products) and capital accounts (overseas repatriation of profits, interest, royalties, management fees, and other funds). Although FDI contribute to public revenue in the form of corporate taxes, their contribution is considerably less than it should be as a result of liberal tax concessions, the practice of transfer pricing, excessive investment allowances, disguised public subsidies, and tariff protection provided by the host government.

Other negative impacts may be discribed as follows: MNCs may damage host economies by suppresing domestic entrepreneurship and using their superior knowledge, worldwide contacts, advertising skills and range of essential support services to drive out local competitors and inhibit the emergence of small-scale local enterpries. With FDI local resources tend to be allocated for socially undesirable projects. This in turn tends to aggravate the already sizable inequality between rich and poor and the serious imbalance between urban and rural economic opportunities.

An economic exercise carried out to investigate the crowding effects of FDI, covers long period of time (1970-1996), but a small number of countries (39 countries, mostly developing ones) showed that, as regards regional patterns, out of the 12 Latin American countries included in the test, non was in the group with crowding-in effects and none of the 12 Asian countries was in the crowding-out group: while neutral and crowding-in effects prevailed in Asia, neutral and crowding-out effects prevailed in Latin America. African countries are found in all three groups[5].

Reconcilling the Pros and Cons

[5] Annex to chapter VI, *World Investment Report 1999*, p.189-91

What impact does FDI have on the standards of living and prospects for economic growth of developing countries and economies in transition that receive it? Two alternative conceptualizations of the impact of FDI guide the understanding of its potential contribution to the economic development in host country. These models predict widely different outcomes. The first, known as the Benign Model of FDI and Development, is of positive impact. The second -Malign Model of FDI and Development - is of negative impact.

The Benign Model of FDI and Development argues that FDI can break vicious circle of underdevelopment (low levels of productivity-low wage-low levels of saving-low levels of investment-and low levels of productivity) by complementing local savings and by supplying more effective management, marketing, and technology to improve productivity[6]. The gain in national income depends on the size of the capital inflow and the elasticity of the demand for capital. Thus, under reasonably competitive conditions- which the foreign presence may enhance - FDI should raise efficiency, expand output, and lead to higher economic growth in the host country.

The Malign Model of FDI and Development argues that foreign companies operate in industries where there are substantial barriers to entry, enjoying and perhaps increasing (rather than decreasing) market concentration (Grieco 1986; Cardoso and Dornbusch 1989). Instead of filling the gap between savings and investment by extracting rents and siphoning off capital through preferred access to local capital markets and local suppliers of foreign exchange, they might drive domestic producers out of business and substitute imported inputs. The repatriation of profits might drain capital from the host country. Their

[6] Gillis et al.1996; Cardoso and Dornbusch 1989.

tight control over technology, high management functions, and export channels may prevent the beneficial spillovers and externalities hoped for in the more optimistic scenarios.

Which of these models better describes FDI in the less-developed countries today? For either of them can be used as the model of the interaction between FDI and host country development requires a multitude of assumptions, most having to do with how competitive the industry and economy are where the FDI takes place. Several studies[7] were undertaken under widely different auspices and with widely different starting perspectives, yet they came to similar conclusions that the factor that determined whether the social benefit to the host country was positive or negative was the competitiveness of sale. That is, the difference came from the competitiveness of the host-country markets, including the competitiveness of input and output markets, which were often influenced by host-country regulatory policy. It is interesting to mention that these studies also showed that a majority of the projects taken in the studies (from 55 percent to 75 percent) would increase national income, while the remaining sizable minority (from 25 percent to 45 percent) would actually reduce the country's national income, even though they were profitable to the foreign investors that undertook them.

The Concept of Competitiveness

Competitiveness has become one of the central preoccupations of government and industry in every country. The term of competitiveness is used with reference to both enterprises, industries and even supranational regions. In general, competitiveness of an enterprise or an industry refers to the potential to produce a good or service at or below the prevailing price without subsidies. The U.S. President's Commision on Industrial Competitiveness used the

following definition of competitiveness for a country: "Competitiveness for a nation is the degree to which it can under free and fair market conditions, produce goods and services that meet the tests of international markets, while simultaneously maintaining and expanding the real income of its citizens".

Comparative advantage, the classical theory, is one of determinants of competitiveness. This theory can be used only for explaining the basic principles that should guide an efficient allocation of resources in an open economy. While economic growth is determined by the productivity of a country's economy, which is measured by the value of the goods and services produced per unit of the country's human, capital and physical resources. Productivity, then, defines competitiveness. Improvements in a country's productivity and competitiveness are a function of three inter-related influences: The political and macroeconomic context; The quality of enterprise operations and strategies; The quality of the business environment.

II. Host Countries Policy Instruments and FDI

The policy challenge for countries, especially developing countries and economies in transition, is twofold: (i) To attract more and more FDI by "incentive wars", a financial incentives-competition race towards the sky; a fiscal incentive-competition towards zero; or a policy-competitive race towards the bottom. (ii) To pursue policies, and implement policy measures, that help countries attract FDI and especially to benefit from it as much as possible – in short, to maximize the contribution that FDI can make to development. This second bundle of policies is the concern of this paper.

[7] Lall and Streeten (1977); Reuber (1973).

Host countries adopt policies designed both to restrict and to encourage inward FDI. During 1950s-1970s, Japan and South Korea were the nations that discouraged FDI inflows. But today most of the developed as well as developing countries consider FDI an important channel for obtaining access to resources for development. The policies resulting from host government intervention are usually known as protectionism and different kinds of performance requirements. Protective policy can have several forms: high import tariff, infant industry protection, import quota system. Performance requirement can be the local content requirement, exports requirement, technology transfer and local participation in top management. The logic underlying performance requirements is that such rules help to maximize the benefits and minimize the costs of FDI for the host countries. Performance requirements tend to be more common in less developed countries than in advanced industrialized nations. Let us look into details of these policies.

Infant Industry Arguments

Infant industry argument is by far the oldest economic argument for government intervention. Developing countries have a potential comparative advantage in manufacturing, but new manufacturing industries in these countries cannot initially compete with well-established manufacturing in developed countries. To allow manufacturing to get a toehold, governments should temporarily support new industries (or "picking winner"), until they have grown strong enough to meet international competition. Thus it makes sense, according to this argument, to use tariffs or import quotas as temporary measures to get industrialization started. It is historical fact that the world three largest market economies all began their industrialization behind trade barriers: The U.S. and Germany in the 19th century, while Japan had extensive import controls until the 1970s. The infant industry argument seems

highly plausible, and in fact it has been persuasive to many governments. Yet economists have pointed out pitfalls in the argument, suggesting that it must be used cautiously.

It is not always good to try to move today into the industries that will have a comparative advantage in the future. Suppose that a country that is currently labor abundant is in the process of accumulating capital: When it accumulates enough capital, it will have a competitive advantage in capital-intensive industries. That does not mean it should try to develop these industries immediately. In the 1980s, for example, South Korea became an exporter of automobiles; it would probably not have been a good idea for South Korea to have tried to develop its auto industry in the 1960s, when capital and skilled labor were still very scarce.

Protecting manufacturing does not good unless the protection itself helps make industry competitive. In case after case, however, protection seems to have done little more than foster the development of inefficient industries that have little hope of ever competing in the world market. Brazil, for example, built the world's 10th largest auto industry behind tariff barriers and quotas. Once those barriers were removed in the late 1980s, however, foreign imports soared and the industry was forced to face up to the fact that after 30 years of protection, the Brazilian industry was one of the world's most inefficient[8].

As with all infant industry arguments, crowding out is economically undesirable if three conditions are met. First, infant local enterprises are able to mature to full competitiveness if sheltered against foreign competition through trade and/or FDI. Second, the maturing process does not take so long that the discounted present social costs outweigh

[8] Brazil Auto Industry Struggles to Boost Global Competitiveness, "Journal of Commerce, October 10, 1991, p.6A.

the social benefits. Third, even if there are net social costs, there must be external benefits that outweigh them.

In a dynamic world, a protect infant industry might mature into a strong one worldwide because of an acquired, but real, comparative advantage. If such an industry is undercut and driven out of world markets from the beginning, that comparative advantage might never develop.

Import Substituting Policy

Most developing countries have pursued import-substituting programs of industrialization with emphasis on the local production of final consumer goods. Final goods production is generally less technically sophisticated than intermediate capital-goods production. The expectation was that in time, rising demand and economies of scale in finished-goods production would create strong backward linkages leading to the creation of domestic intermediate-goods industries. The record of performance has been disappointing for most developing countries. Part of the reason for this lack of success has been that developing countries tariff structures have afforded exceedingly high rates of effective protection to final-goods industries while intermediate and capital goods have received considerably less effective protection. The net result is an attraction of scarce resources away from intermediate-goods production and toward the often inefficient production of highly protected final consumer goods.

High Tariff Issues

With high tariffs, who gains and who suffers? The government gains, because the tariff increases government revenues. Domestic producers gain, because the tariff gives them some protection against foreign competitors by increasing the cost of imported goods.

Consumers lose since they must pay more for certain imports. Two conclusions can be derived from a more advanced analysis. First, tariffs are unambiguously pro-producer and anti-consumers. A study by Japanese economists calculated that in 1989 restrictions on imports of foodstuffs, cosmetics and chemicals into Japan cost the average Japanese consumer about $890 per year in the form of high prices[9]. A second point is that the tariff reduces the overall efficiency of the world economy. They reduce efficiency because a protective tariff encourages domestic firms to produce products at home that, in theory could be produced more efficiently abroad. The consequence is an inefficient utilization of resources.

However, tariff protection has following advantages: represent the major source revenue for host government, and encouraging foreign business interests to invest in local import-substituting industries, because, from TNCs' viewpoint, to hedge high tariff barrier for spreading products in protected market, FDI is one of the solutions. Although these arguments can sound convincing and some protective policies have proved highly beneficial to the developing world, as we discovered, many have failed to bring about their desired results. Protection does have an important role to play in the development of the Third World, for both economic and non-economic reasons, but it is a tool of economic policy that must be employed selectively and wisely, not as panacea to be applied indiscriminately and without reference to both short- and long-term ramifications[10].

[9] Y. Sazanami, S. Urata and H. Kawai, *Measuring the Costs of Protection in Japan* (Washington, DC:

Box 2.1 The costs of protectionism in the United States during 1980s

The study, by Gary Hufbauer and Kim Elliott of the Institute for International Economics, looked at the effect of import tariffs on economic activity in 21 industries with annual sales of $ 1 billion or more (during the 1980s) that the United States protected most heavily from foreign competition. The industries looked at included apparel, ceramic tiles, luggage and sugar. In most of these industries import tariffs had originally been imposed to protect U.S. firms and employees from the effects of low-cost foreign competitors. The typical reasoning behind the tariffs was that without such protection, U.S. firms in these industries would go out of business, and substantial unemployment would result. So the tariffs were presented as having positive effects for the U.S. economy, not to mention the U.S. Treasury, which benefited from the associated revenues.

What the study found, however, was that while these import tariffs saved industries that would otherwise have been lost to foreign competition, they also cost American consumers about $32 billion per year in the form of higher prices. Even when the proceeds from the tariffs that accrued to the U.S. Treasury were added into the equation, the total cost to the nation of this protectionism still amounted to $10.2 billion per year, or over $50,000 per job saved.

Moreover, the two economists who undertook the study argued that these figures understated the true cost to the nation of the tariffs. They maintained that by making imports less competitive with American-made products, tariffs allowed domestic producers to charge more than they might otherwise because they did not have to compete with low-priced imports. By dampening competition, even a little, these tariffs removed and incentive for firms in the protected industries to vecome more efficient, thereby retarding economic progress. Further, the study' s authors noted that of the tariffs had not been imposed, some of the $32 billion freed every year would undoubtedly have been spent on other goods and services, and that growth in these areas would have created additional jobs, thereby offsetting the loss of 200,000 jobs in the protected industries.

Source: C. Hufbauer and K. A. Elliott, *Measuring the Costs of Protectionism in the United States* (Washington, DC: Institute for International Economics, 1993), and S. Nasar, "The High Costs of Protectionism", *New York Times*, November 12, 1993, pp. C1, C2.

Local Content Requirement

Local content requirement is a demand that some specific fraction of a good be produced domestically. The requirement can be expressed either in physical terms or in value terms. Local content regulations have been widely used by developing countries

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Institute for International Economics,1994)

to shift their manufacturing base from the simple assembly of products whose parts are manufactured elsewhere into the local manufacture of component parts. Local content regulations provide protection in the same way an import quota does: by limiting foreign competition. Here, domestic producers benefit, but the restrictions on imports raise the prices of imported components. In turn, higher prices for imported components are passed on to consumers of the final product in form of higher prices.

Local content requirement also have other negative effects. A survey conducted under the auspices of the United Nations Center on Transnational Corporations (1991) found high inefficiency and a pronounced tendency toward stasis in industries where hosts imposed domestic-content requirements: effective rates of protection ranged from 50 percent to more than 600 percent, consequent prices were 200 percent to 300 percent higher than the cost for comparable products outside the host country, the intensity of use of those products was reduced to much less than half of what might be expected by international standards, the net social contribution of the investor activity was sometimes far in the negative column, and there was little evidence of dynamic-learning effects of movement toward competitive status. Evidence from the automotive, petrochemical, and electronics/computer sectors demonstrates the adverse consequences.

In the automotive industry, Bale and Walters (1986) found that 16 countries that mandated domestic content from 18 percent to 100 percent on foreign operations with less than 100,000 vehicle-per-year output had to support those operations with ad valorem import tariffs averaging nearly 100 percent. In a classic study of the Indian automobile industry's experience with domestic-content regulations, Krueger (1975) calculated that 27

[10] Michael P. Todaro, Economic Development, 6th edition, 1997.

of 34 assemblers and associated suppliers received effective rates of protection above 50 percent, with almost half of the firms enjoying more than 100 percent protection (the highest figure, for a metal fabricator, was 642 percent). If the effective rate of protection had been limited to no more than 50 percent, Krueger calculated, value added in production would have in creased by more than one third; instead, increasing costs and economic losses spawned more protectionist trade and foreign exchange practices to prop up the uncompetitive plants.

There is also evidence of lags in the introduction of new technology to projects with high domestic-content requirements, independent of scale. In the automotive sector, Doner (1995b) found similar delays in the introduction of new technology to projects with high-domestic-content (80 percent), highly protected Malaysian automotive market. Ernst (forthcoming 1998) observes a lag in the utilization of more advance management systems, including quality control circles and just-in-time inventory control. The end result is that foreign corporations, domestic firms, and a labor elite from the population at large receive trade rents created at great cost in terms of inefficiencies for the economy as a whole.

Joint-Venture Requirement

The rationale for giving preference to or requiring joint ventures is to try to capture more of the benefits that foreign investors have to offer. In particular, host countries want to achieve greater "technology transfer", expanded access to external markets, strengthen backward linkages to the domestic economy…through joint ventures. The joint venture relationship offers benefits to all parties. From foreign partner's viewpoint, local partner can provide location-specific knowledge regarding host-country markets, local tastes, local business practices, local labor practices, local suppliers, and local business-government relations.

At the same time, however, joint-venture form also some time creates some difficulties that affect the goal of the joint ventures in term of reducing revenues, increasing production costs, principal-agent conflict…especially for investor activities that involve rapid technological innovation, export intensity, advertising intensity, a large degree of brand recognition and product differentiation and large economies of scale in production[11]. In these cases foreign partners are likely to refuse joint venture and prefer wholly foreign-owned affiliates. Kogut (1988) finds that conflict among the partners and joint-venture termination increased as a function of the degree of coordination that the parents desire between the subsidiary and other corporate operations. Gomes-Casseres (1989) trace conflict to differences of perspective between the foreign and domestic partners on quality standards, exports, and the pricing of goods and services.

But in many cases, TNCs when entering host countries, are forced to set up joint ventures instead of wholly foreign owned affiliates. In survey of 66 joint ventures located in 27 less-developed countries, Beamish (1988) found that while 43 percent were created because the parent needed the local partner's skills, assets, or other attributes, a sizable majority (57 percent) resulted purely from host-government pressure or legislation. About the source of conflict, Beamish (1988), like Rugman (1985) and Parry (1985) suggests that "opportunism" of the indigenous partner is at fault. In particular, he points to leakage of technology and appropriation of knowledge gained within the joint ventures arrangement as the primary reasons for dissatisfaction and failure.

III. The Changing Context of World Economy

[11] Stopford and Wells 1972.

The global context for development has changed enormously over the past three decades. These changes affect not only the role of FDI in host countries, but also government policies on FDI. The following three are of particular significance.

The nature and pace of knowledge-and particularly, technological knowledge –change: The creation and diffusion of productive knowledge have become central to growth and development (Mytelka, 1987; Dunning, 1997). "Knowledge" includes not only technical knowledge (research and development, design, process engineering), but also knowledge of organization, management and inter-firm and international relationships. Today, the resources devoted to such knowledge exceed investment in tangible machinery and equipment in many of the world's most dynamic firms, and the costs of generating new knowledge are rising constantly. The processing of information and trade in information-intensive services if one of the most important occupations in today's knowledge-economy.

Shrinking economic space and changing competitive conditions: Technical progress in transport and communications has caused economic space to shrink dramatically. Countries now face much more intense and immediate competition than ever before. This leads to a significant restructuring of their comparative advantages and activities. The nature of competition itself is changing, with the rapid introduction of new products, shorter product cycles, flexibility o response to demand, and customer interaction becoming more important than traditional forms of competition based on lower costs (Best, 1990). At the enterprise level, this calls for new management and technical skills and organizational forms. At the national level, it requires countries to be more open to international flows of information, and to improve national capabilities to absorb and use that information: to develop new skills, institutions and innovative capacities.

Changing attitudes and policy regimes: Most developing and transition countries have moved to market-oriented and private sector led economies. This shift reflects disillusionment with past strategies and growing difficulties in pursuing them in the new technological and competitive setting. The shrinking of economic space has itself rendered elements of traditional strategies obsolete, while the flow of information has made governments more aware of policies and performance in other countries. There is widespread reduction and removal of trade barriers, deregulation of internal markets, privatization and liberalization of technology and investment flows at the national level. At the international level, regulation has intensified and is being harmonized. For instance, the TRIPS (Trade-Related Aspects of Intellectual Property Rights) agreement of the Uruguay Round has introduced a common, more rigorous, system of intellectual property protection; the TRIMs (Trade-Related Investment Measures) agreement has established disciplines over certain performance requirements; and quality requirements such as ISO standards are becoming prerequisites for participating to the international plane.

The Lessons from North East Asian Nations

Throughout the 1950s and 1960s, East Asia benefited from special relationship with the U.S. South Korea and Taiwan adopted a neomercantile ideology of economic development with anti-communism and rapidly expanded their intervention in both the economy and society in order to actively promote export-oriented industries. Thus, one crucial effect of U.S. aid to East Asia was the strengthening of the states in South Korea and Taiwan relative to business, labor, farmers, and other social classes (Kim,1989, pp.70-79). On the trade side, East Asian nations also benefited from the trade with the U.S. While the U.S. opened market to

these countries' commodities, the U.S. government did not require South Korea and Taiwan open their markets to U.S. goods.

During the 1970s and 1980s many developing countries wishing to follow Taiwan and South Korea policy, faced the poor rate of growth, massive inflation, high debt and growing balance of payment deficits. Many observers attribute them to the rising burden of public spending, excessive price distortions and inward-looking trade policies. In these countries, the public sector has grown dramatically over the past three decades, now accounting for 15 percent to 25 percent of GDP and some 40 to 50 percent of total investment. However this growth has been accompanied by considerable inefficiency and waste. Many of the "free marketeers" assert that a greater role for private enterprise in undertaking projects could lead to more efficient utilization of resourses.

The world economic environment has been changed a lot today. And as the result of the disenchantment with central planning and the perceived failure of government intervention, a growing number of economists, some financial ministers in developing countries, and the heads of the major international development organizations have begun in recent years to advocate the increased use of the market mechanism as a key instrument for promoting greater efficiency and more rapid economic growth. The developing countries can not duplicate the lessons drawn from North East Asian nations, especially their trade and industry policy.

Chapter 3

FOREIGN DIRECT INVESTMENT IN VIETNAM

Policy attracting Foreign Direct Investment is important strategy of Vietnamese government in building and developing several key industries in the country. This chapter will review the achievements and weaknesses in attracting FDI resource in Vietnam, in which the role of the government policy will be emphasized. But at first, we look at the picture of Vietnam's economy since renovation process was introduced, with the emphasis on the trade an industrial policies which can potentially affect the effectiveness of domestic as well as external investment resources.

I. An Overview of Vietnam's Economy

After years as a closed economy, Vietnam opened up to the outside world in 1986 with the introduction of *Doimoi* program (renovation policy). The central idea of Renovation is a shift of the national economy from a centrally planned to a market-oriented economy with the state management. From under the long-period war and long-standing backward and stagnant economy, the country has waken up and gained the remarkable social-economic achievements since Doimoi. The country escaped the social crisis that Former Soviet Union and East European nations suffered during 1989-91, and survived the U.S. trade embargo (which was abolished in 1994) and achieved high GDP's growth rate of 7.56 percent annually for the last ten years (in period 1993-1997 the figure was 9 percent). Industrial production enjoys a sustainable growth of 13.6 percent annually in period 1991-2000, in which foreign invested sector grows at highest rate and plays a growing role. Many aspects of life have been improved in the country. The poverty rate has been reduced from 30

percent in 1992 to 11 percent in 2000. Vietnam's Human Development Index (HDI) improved from 0.464 in 1992 to 0.671 in 2000, being at 108th out of 174 countries.

Table 3.1 Fixed assets in industrial production by sector, percent

Year	Total	State	Non-state	Foreign invested
1990	100	52.5	11.4	36.1
1995	100	50.9	15.0	34.2
1999	100	32.7	12.8	54.5

Source: General Statistics Office, Hanoi, 2001.

Vietnam is clearly in the list of poor nations, with per capita income of US$400 (purchsing power parity US$2000), nominal GDP was about US$30 billion in 2000. However, Vietnam, unlike other poor nations, has no shortage of natural resources. In fact, there is such an abundance that Vietnam is the world's third leading exporter of rice, and a small but consistent producer of crude oil that provides almost one third of the nation's annual income. Almost no comparison can be made between the opportunities of the starving nations of Africa and the inertia of Vietnam, other than their per capita income.

Vietnam is in very low stage of its development. The weaknesses can be observed in every corner of economy. The domestic savings rate is low (18 percent of GDP per year), low investment rate (28 percent of GDP per year) causing Vietnam's economic growth to rely, to a considerable extend, on foreign finance if wish to achieve a GDP's growth rate of 10 percent. The indicator of ICOR (Incremental Capital Output Ratio) was 3.0 in 1995, 3.5 in 1996 and 4.5 in 1999. The majority of goods and services are of low quaility and high price, uncompetitive even in the domestic market. The unemployment rate among working force in Hanoi and Ho Chi Minh city has been on increase since 1996 (5.88 percent in 1996, 6.85 percent in 1998, 7.40 percent in 1999). The main comparative advantage of the

country is potential in terms of a hard working, intelligent and quick learning workforce, in addition to the unexploited resources. Vietnam's market economy is not fully established in all its elements and does not yet operate smoothly. An intellectual property, a real estate and labor markets are either non-existent or only in very early stages of development. Financial market is weak, legal framework is insufficient. The market mechanism is seriously distorted by an unequal playing field in which advantages are given to different sectors of the economy, where unfair competition and the monopoly of many state-owed enterprises (SOEs) exist. In Vietnam, forty percent of SOEs are not making consistent profits, another 40 percent are hardly achieving any success at all and the other 20 percent are losing. The economy's competitiveness and efficiency are still low and have improved only slowly at both national and company levels. At present, the share of competitive products and services is small, most being agricultural products. Public services are all in the hands of monopolist SOEs which are requesting strong protection by the Government and, defended by some interest groups, are unwilling to accept competition[12].

A recent study of effective rates of protection (CIE 1998) in Vietnam indicated that effective rates of protection (ERP) vary greatly between sectors, and certain industries are being supported at very high economic cost. In some cases, quantitative restrictions are significantly increasing protection available to local producers. Among 30 main industries, 10 industries have the effective rates of protection by input-output industry more than 100 percent, ranging from 100 percent to 256.5 percent.

The problem at the moment is that the general policies are to encourage inefficient import substitution, which will be discussed in details through the case of automobile industry

[12] Le Dang Doanh, Development and Economic Reform in Vietnam, The Quarterly Newsletter of the

later. This policy needs much of foreign exchange earnings, which is the limited source in Vietnam. The solution may be that, Vietnam should welcome efficient import substitution, as well as expansion of export that is critical for development. Since domestic market is small, rapid output and employment growth can only come from enterprises targeting external markets.

With the objectives becoming an industrialized country in 2020, set by Vietnamese Government, key policies issues are industrialization model, globalization and economic integration, the effective utilization of human resources, and state administration reform. With regard to the industrialization model, the question is in what way the industrialization process should be undertaken nowadays in light of fierce international competition and the stormy progress of science and technology. Should this process be undertaken on the basis of Vietnam's comparative advantages or focused from the beginning on building up foundation industries such as heavy industries, mechanical engineering, metallurgy and chemistry?

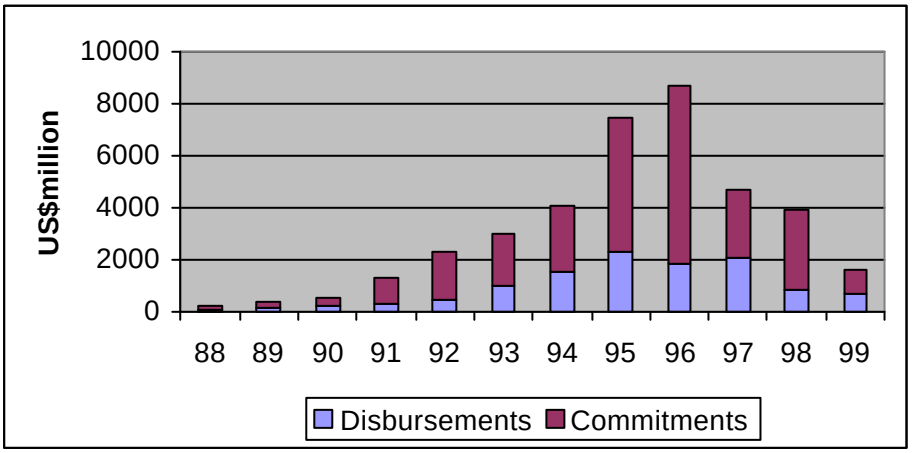
Trade and industry policy reform is crucial for Vietnam for a number of reasons, related primarily to the role that open trade policies can play as a means of ensuring competitiveness and efficiency of resource allocation, and of disciplining enterprise investment and production decisions. However, any form of industry furtherance must conform to the rules of institutions such as AFTA (ASEAN Free Trade Area) and the WTO (World Trade Organization). To avoid conflict here, Vietnam should incorporate future plans for individual industry furtherance, into negotiations with AFTA and WTO.

II. Foreign Direct Investment in Vietnam

Vietnam is a country of great potential for foreign direct investment. Attractive factors are relatively rich natural resources (including oil, gas, coal..), large agricultural potential, relatively large domestic market (78 million people), and good geographic location.

To improve investment climate and foster cooperation, Vietnam has signed the AFTA, signed Market Opening Agreements with European Union and Japan. During 1990s, Vietnam concluded 39 Bilateral Investment Treaties (BITs) which provide additional guarantees for foreign investment, and 26 Treaties for the Avoidance of Double Taxation (DDTs) on income and capital. Vietnam is a member of the Multilateral Investment Guarantee Agency (MIGA) and the World Intellectual Property organization (WIPO). Signing BTA with the U.S. on July 2000, Vietnam commits to implement more reforms aimed at achieving greater global integration, including membership in the WTO.

Figure 3.1 FDI inflows in Vietnam during period 1988 – 1999



Source: Vietnam' s Ministry of Planning and Investment.

FDI's Contribution to The National Economy

The first bulk of FDI flew into Vietnam in 1988. Since then the commitments of FDI continuously grew from US$234 million in 1988 to US$8.6 billion in 1996. However, in 1997 the amount dropped to US$4.6 billion, in 1998 - to US$3.9 billion, in 2000 - to US$2.4 billion. From 1988 to 2000 total commitment FDI inflow reached US$36.4 billion.

There are 2620 projects in operation with implemented capital of US$20 billion, of which foreign capital is US$18 billion. The FDI sector generates more than 12 percent of GDP, 34 percent of industrial production value, and approximately 7 percent of government budget revenues. The following table shows that Vietnam's FDI/GDP ratio in the years before 1998 was the one of the highest among active FDI host countries, more than several times higher than developing country averages, even higher than China – the leading FDI recipient country in terms of absolute volume.

Table 3.2 FDI inflows per US$1,000 GDP

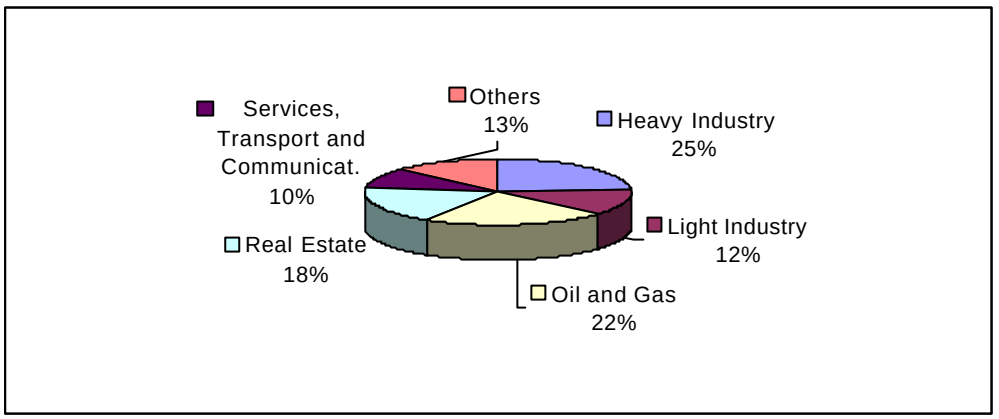
Country, region	1993	1994	1995	1996	1997	1998	1999
Vietnam	67.9	124.8	116.1	105.2	108.5	80.2	56.3
China	63.7	62.3	51.2	49.2	49.0	45.5	40.8
Malaysia	89.5	63.2	66.6	73.5	66.1	40.0	47.3
ASEAN 10	30.7	32.2	31.4	34.7	32.5	30.6	20.7
Developing country	18.2	21.5	20.2	23.7	27.5	29.0	32.8
World	9.4	9.9	11.6	12.8	16.0	23.3	28.7

Source: UNCTAD, FDI/TNC database

FDI inflow by sector is assessed favourable for the economic development. In some important industries, the share of FDI accounts for larger part, such as 100 percent in gas and oil exploitation, 70 percent in steel manufacture and steel structure, 54 percent in steel rolling, 50 percent in electronics, 40 percent in cement production..FDI flows has also

given a substantial boost to industrial output, especially in mining and manufacturing sectors. Foreign invested sector accounted for 25 percent of Vietnam's industrial gross output in 1995, 28.9 percent in 1997, 35.5 percent in 2000, while the share of the state sector is on decrease.

Figure 3.2 Disbursement FDI Stock by Sectors, as of mid 1998



Source: IMF (1999)

The share of exports and imports by FDI projects in national total trade has been increasing. The share of FDI exports in the national exports increased from 4.0 percent in 1994 to 21.2 percent in 1998, 23.2 percent in 2000. On the imports side, the FDI share in total imports increased from 10.3 percent in 1994 to 23.2 percent in 1998, 28.6 percent in 2000. FDI in Vietnam has originated from over 40 countries, but it has largely been driven by intra-regional flows, which account for two-thirds of the total FDI commitments through the end of 2000.

FDI Legislation

In 1987, Vietnam opened up to foreign investors with the promulgation of the Foreign Investment Law and other legislation (FIL), considered one of the most liberal in the Asia-Pacific region. The regulatory framework was further liberalized by amendments to the law

in 1996, 1999 and 2000. FIL encourages foreign investment in all economic sectors and localities except some essential areas affecting the country's security. The investment forms are Business Cooperation Contract (BCC), Joint Venture Company (JVC), 100 percent Foreign Owned Enterprise (FOE), Build-Operate-Transfer (BOT). The FIL is more liberal than other Asian countries in term of taxation, tax holidays and financial incentives. For example, foreign invested enterprises are exempt from paying duty on the import of equipments and materials which form part of the capital contribution of the foreign investment. The FIL also states that where the benefits of a licensed foreign investor are "reduced due to the change in the law of Vietnam, the State shall take appropriate measures to protect the interest of the investors"…

Beside positive policies, there remain policies considered not favorable for investment environment. Performance requirement, such as localization of production and export commitment for specific industries and projects, are applied. The principle of private ownership of land does not yet exist in Vietnam (land leases to foreign entities may be granted up to 50 years, or in special circumstances 70 years). Vietnam's FDI environment is not fully attractive for investors for weak and cumbersome administrative machine in all level, central as well as local level, and pervasive corruption. The other disadvantages are mentioned in the following parts.

Performance of FDI Projects

The actual disbursement rate fluctuated around small percentage, 34 percent on average. The low FDI disbursement in Vietnam is partly attributed to complicated procedures to

implement projects after licensing[13]. Two-thirds of total FDI commitments during 1991-1998 were made in joint ventures with SOEs, and only a

moderate percentage with the private sectors. There have been several cases reported on the unpleasant issues raised in some joint ventures in Vietnam, such as conflict between partners in main matters such as production plan, personnel training, product prices, staff wage. Other problems are dual pricing, transfer pricing, discrimination against private firms, difficulties in accessing land, the business approval and labor recruitment processes..In results, the performance of foreign invested enterprises (FIEs) have been poor. In 1997, there was 576 FIEs (of total 860) reported incurring loss, in 1998 the number was 702 FIEs (of total 981). Foreign partners in many joint ventures have expressed the wish to shift current joint venture format into foreign wholly-owned enterprise (the case of Vietnam Daewoo Motor Corporation). Net impact of FDI on Vietnam's trade balance has been negative. Persistent trade deficits have been recorded as a result of direct operations of FDI projects (due mainly to the low share of export-oriented FDI project). Weak FDI's contribution to the improvement of trade performance indicates that much of FDI has been channeled to import-substituting industries (heavy industry, light industries producing consumer goods) or non-tradable (construction, large segments of transportation and telecommunications, office and apartments).

The loan component of FDI inflows rose sharply in recent years, reaching 70 percent of total disbursement in 1997, compared with 6 percent in 1992. This trend suggests that large repayments on FDI-related loans will fall due in the next few years, when the external environment will likely remain considerably less favorable in the mid-1990,

[13] Kwang W. Jun, Duc Minh Pham, *Foreign Capital Flows in Vietnam*, Background paper for the World

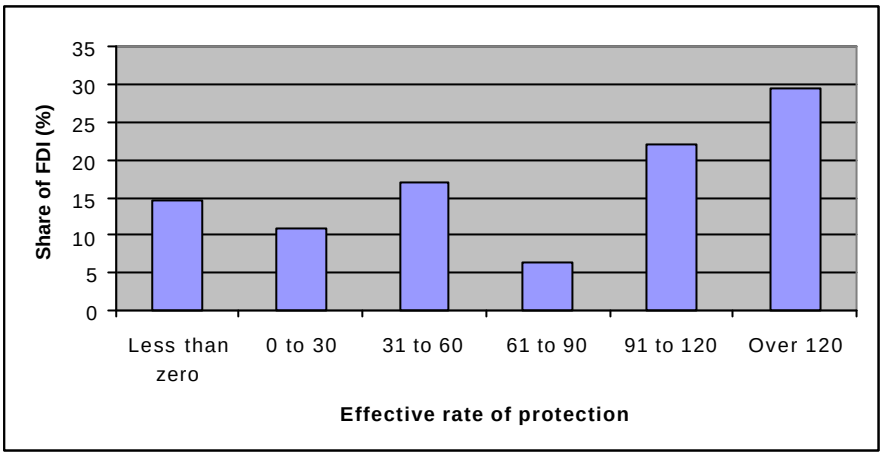
when investment decisions were originally made. The impact on employment is small, foreign investment accounted for almost one third of industrial production but only for 12 percent of employment in 1998. By 1998 foreign enterprises have created 477,000 wage jobs (not included 1 million indirect jobs), representing only 6 percent of wage jobs and just over 1 percent of total employment in Vietnam.

Misallocation of FDI in Vietnam

From 1997 there was a sign of slowdown of FDI inflow in Vietnam. It is partly due to the Asian financial crisis, partly due to the weaknesses in Vietnam's investment environment. The slower pace of new FDI commitments also reflects increasing market saturation in certain sectors, especially in the import substitution areas such as motor vehicle, motor cycles, cement and steel…

A recent study of effective rates of protection (ERP) also showed that both domestic and foreign investment in Vietnam is being directed toward sectors with relatively high levels of protection and not towards sectors that are viable with low levels of protection. Following chart shows the distribution of the value of FDI projects according to the effective rate of protection of the sector to which each project is classified. Some 14 percent of the value of FDI is in sectors with effective rates less than or equal to zero – most of which being oil or gas projects. However, around 50 percent of investment is in sectors with ERP over 90 percent, and a quarter is in sectors with ERP over 120 percent. **Figure 3.3 The relationship between FDI and effective rate of protection**

Bank, 1997



Source: CIE estimates

(An intuitive way of interpreting these results is to think of what they imply for the costs of saving foreign exchange by producing goods through these projects rather than importing them. In a project reliant on an ERP of 120 percent, every $1 saved costs $2.20 in theservices of local labor, capital and land used in the production process)[14].

Box 3.1 Nominal and Effective Rate of Protection

To measure the degree of protection, we need to ask by how much these restrictions cause domestic prices of import to exceed what their prices would be if there were no protection. There are two basic measures of protection: the nominal and effective rates of protection.

The *nominal rate of protection* shows the extend, in percentages, to which the domestic price of imported goods exceeds what their price would be in the absence of protection. The nominal (ad valorem) tariff rate (t) refers to the final prices of commodities and can be defined as $t = (p' - p)/p$ where p' and p are the unit prices of industry's output with and without tariffs, respectively.

By contrast, the *effective rate of protection* shows the percentage by which the value added at a particular stage of processing in s domestic industry can exceed what it would be without protection. In other words, it shows by what percentage the sum of wages, interest, profits, and depreciation allowances payable by local firms can, as a result of protection, exceed what this sum would be of these same firms had to face unrestricted competition (no tariff protection) from foreign producers. The effective rate (g) can therefore be defined as the difference between value added (percent of output) in domestic prices and value added in world prices, expressed as percentage of the latter, so that $g = (v' - v)/v$ where v' and v are the value added per unit of output with and without protection, respectively. The effective rate is the useful concept (but more difficult to measure) because

[14] Trade and industry policies for economic integration, CIE Canberra & Sydney, 1999.

it shows a net effect on a firm or industry of restrictions on the imports of both its outputs and inputs.

Source: Michael P. Torado, Economic Development, 7th edition, Massachusetts: Addison-Wesley

The picture that clearly emerges is that instead of using FDI to develop a solid export base in low-cost, labor intensive industries, which was the approach followed, for example in China since the early 1980, FDI in Vietnam has been channeled to high-cost, capital- and import-intensive industries in which Vietnam has no comparative advantage. The lesson of the Asian economic crisis is that to gain significant economic benefits from FDI for manufacturing, host country economies must be dynamic enough to utilize investment in a way that they become profitable in the short term, not the long term which the Vietnamese government policy is being aimed at. This long term policy or the fact that government cannot define the net impacts of FDI on economy which are resulted from its current policies, are the reasons for misallocation of resources in Vietnam. Therefore, there is a need for Vietnam not only to learn experiences from more developed nations but also to follow international institutions' advices, which are drawn from the researches based on changing context of world economic environment.

Chapter 4

FOREIGN DIRECT INVESTMENT IN VIETNAM' S AUTOMOBILE INDUSTRY

Before Renovation started in 1986, Vietnamese automobile[15] industry was very weak and small. The tiny demand for passenger vehicles was met through the import of fully assembled Soviet-built sedans. Other state-run companies manufactured agricultural vehicles, freight trucks and construction vehicles, but these companies struggled to compete with imports from the Soviet Union and China. In early 1990s, Vietnamese automobile industry began to change dramatically with an establishment of many vehicle-assembling facilities through foreign direct investment. Wishing to have its own automobile industry, Vietnamese government is conducting policies to protect this infant industry. Despite an influx of foreign automobile assemblers into the country, the outcome has not been sustained development. This section will describe the standing of automobile industry in Vietnam with problems, policies and possible recommendations.

I. An Influx of Foreign Automakers to Vietnam

Since the first automaker came to Vietnam in 1989, there has been total 11 foreign automakers establishing their production facilities in this small market (excluded three projects of Chrysler, Nissan and Peugeot not implemented so far and several project applications not accepted). These automakers are the most well known in the world, such as Daimler Benz (Germany), Ford (USA), Toyota, Mitsubishi, Suzuki, Hino, Isuzu, Daihatsu (Japan) and Daewoo, Ssangyong (Korea)... All auto assembly projects

[15] The term automobile here implies several kinds of motor vehicles like passenger car (saloon car,

were established in the form of joint ventures (JV), in which foreign partners usually have from 65 percent to 80 percent of the equity of the companies, and Vietnamese partners are usually state owned enterprises. The total commitment capital of these projects are US$574.7 millions with planned production capacity up to 120,000 vehicles per year. Up to now about US$364 million, accounts for 63 percent of total committed capital, has been implemented.

Of 11 foreign investors, nine are "automakers", firms that design, develop, manufacture, and sell highway-grade motor vehicles, while the remaining two firms are "license assemblers", companies that assemble vehicles from automaker-supplied kits of parts to sell locally under license (Mekong and Vietnam Motor Corporations-VMC). There are also some auto-parts manufacturers coming to Vietnam and set up their production facilities. Vietnam is also an attracting place for motorbike manufacturers. So far five motorbike companies together with Vietnamese partners have established joint ventures, with the total invested capital of US$356 million and total designed capacity of 1.5 milion units per year.

Why so many auto companies came to Vietnam, a poor country with low income per capita? In automakers' home countries automobile industry is suffering slow growth, market saturation and increased competition, it is expected that future growth will occur in emerging markets with large population, such as China, Brazil, India and Vietnam. The number of people per car in each country is also a good measure of market penetration. In Vietnam 950 people had one car in operation, the figure in China was 488, in India 245, in

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minibus, large bus), commercial vehicles (small truck and 4WD) and auto part industry.

Russia 16, in Chile 10.8, in Japan 2.9 and in United State 1.7[16]. It is worth to mention other reasons. Automobile sector is highly

protected by the Vietnamese government, and foreign companies want to hedge the trade barriers by direct investment in the host country. The next reason is to exploit locales that can serve as export platforms to other countries, particularly China (the biggest market of the world) and members countries of ASEAN.

Table 4.1 Motor Vehicle Assembly Plants in Vietnam, 2000

No	Joint Venture	Foreign Partner	Start Date	Capital US$ m.	Capacity unit/year	Location
1	Isuzu Vietnam Co., Ltd.	Isuzu (Japan)	1990	50	10,000	Ho Chi Minh city
2	Vietnam Motor Corp. (VMC)	Colombian (Philippine)	1992	58	10,900	Hanoi
3	Mekong Corp. (Mekong)	SsangYong (Korea)	1993	36	10,000	Ho Chi Minh city
4	Vietnam Daewoo Motor Corp.	Daewoo (Korea)	1995	32.2	10,000	Hanoi
5	Vietindo-Daihatsu Automotive Corp	Daihatsu (Japan)	1996	32	3,600	Hanoi
6	Vinastar Motors Corp. Mitsubishi	Mitsubishi (Japan)	1996	53	9,600	Ho Chi Minh city
7	Vietnam Suzuki Corp.	Suzuki (Japan)	1996	34.2	12,400	Dong Nai
8	Toyota Vietnam Co., Limited	Toyota (Japan)	1996	89.6	20,000	Vinh Phuc
9	Mercedes-Benz Vietnam Ltd.	Daimler- Benz (Ger)	1997	70	11,000	Ho Chi Minh city
10	Ford Vietnam Limited	Ford (USA)	1997	102.7	20,000	Hai Duong
11	Hino Vietnam Limited	Hino (Japan)	1997	17	1,760	Hanoi
	TOTAL			574.7	119,360	

Sources: Ministry of Planning and Investment, Vietnam, 2000.

[16] Calculated from Country Staistical Yearbooks and Wards PARC, 1995.

Figure 4.1 The location of vehicle assembling plants in Vietnam

(I cannot send this map together with this thesis due to large memory occupied by this map. So please photocopy the map from the thesis, I had sent to KDI school before)

There is a wide range of vehicle models being assembled in Vietnam, including four small cars, three mid-sized cars, two luxury-sports cars, five 15-20 passenger vans, three four-wheel-drive sport-utility vehicles, six light- to medium-duty utility trucks and two medium-duty freight trucks. This 26 automotive models provide enough variety to keep competition and consumer choice high.

II. Vietnamese Automobile Industry Policies

Automobile industry is regarded by the Vietnamese government as a pillar industry in the country, therefore government decides to protect the industry by imposing high tariff on imported cars, and non-tariff import restriction, local content requirement, and other... The effective tax rates of imported cars for CBU and CKD are showed in the following table.

Table 4.2 Tariff and Tax Rates in Vietnam for Various of Automotive Integration

Level of Integration (high to low)	Import Tariff	VAT Tax	Special Consumption Tax	Effective Tax Rate
Before January 1999				
Completely built up (CBU)	60%		150%	210%
Complete knock down level two (CKD2)	55%		30-50%	55-155%
After January 1999				
Completely built up (CBU, saloon car up to 5 seats)	100% CIF	10% (or 20% CIF)	100% (or 220% CIF)	340% CIF
Complete knock down level two (CKD2, passenger car)	20% CIF	10% (or 12% CIF)	5% (or 6.6% CIF)	38.6% CIF

Source: Ministry of Planning and Investment, Vietnam, 1999

The localization policy for the automotive industry is less aggressive than in other ASEAN countries, such as Thailand, Malaysia, and the Philippines. For final assembly of vehicles, current policy in Vietnam calls for 5 percent local content by the fifth year of

operation and 30 percent local content by the tenth year of operation. By contrast, the localization policy in Thailand calls for 60 percent local content by the fifth year. But this localization policies of Vietnam are far too general. First, current policy fails to specify what kind of parts and accessories should be localized before others. Second, little progress has been made to design localization policies to fit the regional perspective that most automotive parts suppliers view their operation in ASEAN. Third, local content ratios should not be set for individual makes but instead per plant or by manufacturer. Fourth, these ratios should be based on the value added method and adjusted to reflect such factors as the value of exports and in-house production of parts.

The use of both local content and other import restrictions together with very high tariffs on vehicles imports form the basis of the strong import-substitution policies followed by a number of developing countries, particularly available during the 1950s and 1960s.

Table 4.3 The Size of Vietnamese Vehicle Market, unit.

Year	1996	1997	1998	1999	2000
Cars imported	19,169	14,002	18,797	10,317	15,740
Locally produced cars	5,523	5,987	4,971	6,962	13,950
Total	24,692	19,989	23,768	17,279	29,690

Source: Vietnam Engine and Agricultural Machinery Corp.

In September 1996, Vietnam formed an automobile industry development task force made up of representatives of government agencies involved in the industry, and announced an automobile industry development policy. The Government in June 2000 approved proposal for regulation concerning the establishment of Vietnam Auto Maker Association (VAMA) to be composed of 11 automakers from various countries in operation in Vietnam.

III. The Current Standing of The Automobile Industry

Capacity underutilization and absence of firm profitability. Among 11 assemblers, most of them are facing loss, some are facing heavy loss. For instance, among heaviest losers, Ford joint venture (JV) lost US$6.4 million, Mercedes-Benz JV lost US$2.15 million, Isuzu JV lost US$1.6 million in 1999. Only few assemblers get profits, Toyota JV made profits of US$5.32 million, Suzuki JV made profits of US$1.15 million in 1999. Auto-assemblers face a grave over-supply situation. Only around 25,000 new vehicles have been sold in Vietnam annually since 1994[17], of which the total number of domestically produced vehicles accounts for a small part (table 4.3). Toyota JV has the largest market share of 35 percent in Vietnamese market. The big four JV are Toyota, VMC, Vidamco and Ford, which hold a combined market share of 75 percent. Capacity utilization rates are extremely low, 10 percent on average. Ford JV, for example, is capable of producing 14,000 vehicles annually, but only 365 units were assembled in 1998, 400 units in 1999, 1,100 units in 2000. In theory, any one of the 11 auto plants has the capacity to satisfy national auto demand single-handedly.

Table 4.4 Sales Volume of Domestically-Produced Vehicles, unit.

Year	1996	1997	1998	1999	2000
Toyota ' s JV	201	1,277	1,836	2,000	4,600
10 other JV	5,322	4,710	3,135	4,963	9,350
Total sales	5,523	5,987	4,971	6,963	13,950

Source: Ministry of Planning and Investment, Vietnam.

By some specialists, despite sales in 2000 being on the up, the new car market in Vietnam in 10 years time is expected to be no higher than about 60,000 units per year,

[17] This is about the number of units that a large assembly plant would produce in one month, and the

which must be shared between 11 car companies, such that no company is expected to be able to achieve economy of scale. The implications of the current lack of profitability in the Vietnamese automobile industry are serious. The loss of too many plants could jeopardize the survival of the industry. The lack of profitability will likely lead to some assembly plants to close.

These sales figures reflect weak domestic purchasing power in the country. According to the experiences of the other ASEAN countries, automobile ownership suddenly increased when per capita GDP exceeded US$1,500–2,000. Vietnam's per capita GDP is currently around US$380 (year 2000), and thus, there is little hope that a major motorization trend will begin in the short-term future. One study (1997) has pointed out that assuming Vietnam's GDP continues to grow at 8 percent, only in 2012 (when GDP per capita reaches US$1,000) the Vietnamese automobile industry would be profitable and in 2029 (when GDP per capita reaches US$4,000) the rapid industry growth would be observed.

The low sales of domestically produced cars has been blamed to government policy that allows the importation of a substantial number of cars, new and old, in addition to a number of illegally imported cars, as shown in the table 4.3. The table 4.4 shows the evidence of the role of government policy in enhancing the development of the industry is a sudden increase of the sales of locally produced vehicles in year 2000. Some experts said that it was thanks to changes in government policies which include the introduction in January 2000 of the Enterprise Law which has created a surge in the number of private

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number that General Motors would produce in North America in a single day.

business registrations[18], the abolishment of sub-licenses for tour operators, the ban on the use of the commercial transport vehicles of a certain age from next year and the import of the pre-1996 vehicles.

It is said to cost the same to assemble a car in Japan, as it is to package and ship those same parts to Vietnam. One automaker manager in Vietnam said that the cars assembled in Vietnam cost the parent company twice what they cost in the home country because of low plant and equipment utilization rates. Consequently, it would be unrealistic to expect Vietnam to be able to export cars in the near future, with the car industry as it is.

Price of the domestically produced cars is 1.5 times higher than imported if import tax is excluded, and about 30 percent higher than imported cars. On everage, imported vehicles sell for 289 percent of USA sale prices, while domestically produced vehicles sell for 163 percent of USA prices. Thus, only a few Vietnamese people can afford to buy cars. It is obvious that, while some elite groups of people in society gain from protective policy over automobile industry, customers are losing because of the cars' high price.

Table 4.5 1997-98 New Locally Produced Vehicle Prices, Vietnam and the United States (US dollars)

Lead firm	Model	Price in Vietnam	Price in USA	Vietnam Price % of USA
Toyota	Corolla	24,000	23,000	185%
Daimler Benz	Mercedes E-series	74,500	45,000	166%
Mazda	626	31,330	20,500	153%
BMW	3-series	49,000	35,000	140%
BMW	5-series	78,000	45,000	173%
Average				163%

Source: Vietnam: Lan,1997; USA: Estimates based on Boston Globe, July 20,1998.

[18] According to MPI, Hanoi, the total of new companies registering in the period from January to June

Lack of an automotive industry supply-base. As far as local content requirement, the result has been far below the expectation. According to statistics from the Ministry of Industry, the Toyota JV currently, the industry's leader in carrying out the process, manufactures just 12 percent of its components locally[19]. Only three or four foreign auto parts manufacturers are currently manufacturing in Vietnam. Because there are so few local suppliers, all locally-produced vehicles are assembled as "complete knock down" (CKD) assembly. The main reason behind this is that domestic businesses are now unable to manufacture products that meet the required standards, while even the indigenous bicycle industry has difficulty surviving with outmoded technology. The other main reason is that the low sales potential has kept auto JV from investing in local production. Even if the situation remains stable and automobile production remains at the CKD level, the Vietnamese economy will continue to derive only modest benefit. Since final assembly represents only about 10 percent of vehicle cost, Vietnam can be said to be currently importing 90 percent of the value of each locally produced vehicle. In reality, the realization of mass-production merits is an important factor in terms of raising local content ratios. In case of commercial vehicle production in Thailand, for example, local content ratios rose significantly after total national production of automobiles exceeded 300,000 units a year.

There are some claims by the Vietnamese authorities on foreign automakers producing vehicles in Vietnam such as, the price of imported components kits for vehicle assembly is set too high, the royalty of technology transfer is too expensive, the wages earned by foreigners in auto JV are set unreasonably too high…And all of these factors are considered attributing to the bad financial situation of auto joint ventures.

2000 was around 6,000, 2.5 times the number for the same period in the previous year.

In short, Vietnamese automobile industry is currently in the grips of a vicious circle. The industry, being even highly protected by host government, has very poor performance. Small size of the market prevents assemblers from reaping the mass-production merits, with the result that market growth is hindered by high production costs. This situation discourages assemblers from investing and may reduce their efforts in such areas as technology transfers, human resource development and the incubation of local companies. Vietnamese customers are losing because of car's excessive high price, foreign investors are losing, local content ratios are low, lack of auto parts supply-base in the country..According to one recent study, the Vietnamese government has to spend US$66,000 per job in automobile industry while received only US$25,000. This means that Vietnamese automobile industry is inefficient, and the government protects this industry with high cost imposed on the economy.

IV. Conditions Facing Vietnam's Automobile Industry

Today Vietnamese automobile industry is facing unfavorable conditions for its development. These are more fierce competition in the regional market, the changing context of world economy toward globalization and internationalization and quickly changing technology of car's production. Let us review some of these conditions.

Trade and Investment Liberalization Issues

Due its inclusion in ASEAN in 1995, Vietnam automatically became a member of AFTA in January 1996, it must be abide with the terms of CEPT (Common Effective Preferential Tariff), in freeing up the mutual trade with other AFTA nations of all products with an ASEAN content of 40 percent or greater, by January 2006 (January 2002 for other

[19] Toyota JV has localized small items such as seats, harnesses, tools, side glass, radio, exhaust pipe,

member countries). This freeing up of trade is to take the form of the removal of non-tariff trade barriers and reduction of import duties to 0-5 percent.

At the same time, Vietnam applied for WTO membership in December 1994, and in July 1998 a WTO working group commenced negotiations and evaluation of Vietnam's application for inclusion. GATT (the General Agreement on Tariff and Trade) - a pivotal tool for WTO activities - is founded around the principles of liberalization, non-discrimination, and mutual benefit. It can be a thorn in the side of developing countries such as Vietnam in its requirements for non-discrimination of domestic and foreign products (GATT article 3) and the elimination of quantitave restrictions (GATT article 11). WTO's TRIM (Trade-Related Investment Measures) agreement exemplifies local content and foreign currency procurenment requirements as forms of non-tariff trade barriers, and developing countries must remove all non-tariff barriers, including local content requirements. As a result, there is a strong possibility that it will be unable to employ the approaches used by other ASEAN countries, such as national car concepts and local content regulations. In short, Vietnam will probably be unable to benefit from the strategies used by other ASEAN governments in the past, which curbed external pressure for liberalization while imposing local content requirements on foreign companies that moved into their territories.

The AICO Scheme

There is a long history of formal "complementarity" schemes in ASEAN Industrial Joint Venture (AIJV) begun in 1983, the Brand-to-Brand Complementary (BBC) scheme begun in 1988, and the ASEAN Industrial Coorperation (AICO) scheme begun in 1996. All of these programs have been based on resource-pooling and market-sharing among ASEAN

antenna, quarter trim, separator bar, spare wheel carrier, package tray trim and spare wheel cover.

members as a way to generate and exploit firm- and industry -level economies of scale. AICO is preferential tariff scheme aimed at promoting mutual complementation between companies based in the ASEAN forum by preemting the realization of AFTA by enforcing final CEPT import duty rates (0-5 percent). The total number of automobile-related items to which AICO was applied in the two years from AICO's inception in November 1996 was mearly 10, rising to 32 by April 2000. Japanese car manufacturers in particular have put AICO to good effect in reinforcing and expanding the scope of part complementation within the ASEAN region. By the end of 1999, for example, Toyota received AICO accreditation for 9 car parts types used in its core Corolla, Camry, Hilux, and TUV models.

Changing Trends in the World's Automobile Industry

Changing trends in the world's automobile industry are likely to have a major impact on Vietnam's automobile industry policy. First, major assemblers and parts manufacturers are increasingly establishing divisions of labor on a global scale. The direction in which the automobile industry evolves in a particularly country will depend to a large extent on whether or not that industry is included in such division of labor. Inclusion in or exclusion from division of labor established in the ASEAN region by foreign vehicle assemblers will have a particularly crucial significance for Vietnam. Second, growing concern about environmental problems and safety has brought a rapid rise in the investment burden on manufacturers. Unless production volumes are extremely high, this investment cost cannot be recovered. Third, production methods of cars are changing, and the pace of technological innovation is rapid. It will be difficult for developing countries to catch up with the developed countries in this area.

V. Recommendations

Based on the profile of Vietnam's automobile industry and changes in international trade and economic environment as well as changes in specific automobile industry, we have some of the following arguments on the development of automobile industry in Vietnam:

(1) To Abolish Current Protection on Automobile Industry

Vietnam began to develop its automobile industry some 30 years later than other ASEAN countries, and the industry has been in very difficult stage of development. On one hand, encouraged by the success of automobile industry in other country, Vietnamese government wants to develop this industry by employing protective policies. On the other hand, as lacking experiences, Vietnam does not have clear and comprehensive master plan on the industry's development, that can help to formulate appropriate policies to effectively protect the industry. The other weaknesses are also clear. Low income per capita which hinders the rise in the demand for automobiles. Vietnam's ability to earn foreign currency, which is a vital prerequisite for the development of automobile industry. The export capacity of the automobile industry is almost zero, and it will be necessary to offset the trade deficit in the automobile sector by exporting other items. Agricultural goods exports are not so big and uncertain, oil exports have been less successful than expected, sharp decline in the pace of FDI inflow, which have supplemented Vietnam's foreign currency income. The trade deficit of the country is chronical (it was US$1.32 billion in 1997, US$980 million in 1998). In addition to small domestic market, slowing down of economic growth, the result of the government's *protection of inefficient capital-intensive industry*. One current study concludes that the "free movement of capital is likely to become allocatively efficient only after trade barriers have come down substantially, particularly barriers on capital-intensive activities in labor-rich countries" (Cooper 1998, p.13).

If the protection helps to enhance the Vietnam's automobile industry and it can become competitive by the year 2006, when, by AFTA regulations, member countries should substantially reduce their tariffs (low to 0 – 5 percent), it is worth to protect this infant industry. This implies that Vietnam has the difficult task of building a competitive automobile industry in the brief time remaining before liberalization. Could Vietnam's automobile industry be strong enough by that time? It is unlikely possible. If not, the government should abolish protection program on the automobile industry today, if wish to utilize FDI resources in a more efficient way. Even the chances of the Vietnamese automobile industry attaining international competitiveness within the next 10-15 years are slim.

(2) To Enhance Domestic Automobile Industry

In the long run, Vietnamese government must remove all kinds of policies protecting the automobile industry, but for the medium term (3 to 5 years), Vietnam could have measures to enhance this industry. As the market size is extremely small, the restriction of imports of both secondhand and new cars is vital to facilitate growth in domestic production levels.

Local car production should be promoted over the long term, based around future expension in the domestic market. The Vietnamese government must provide assistance for the production of a car model targeted at the overall ASEAN market, and development of a local mother plant therefor. The next step should be the maintenance of a viable tariff structure (with progressively lower tariffs for completely assembled cars, KD parts, and KD part components).

The car parts promotion should go in hand with policy to attract FDI. That is, Vietnam should put itself in a position of exporting sought-after parts within the ASEAN region, and use this place of privilege to attract parts makers from advanced parts

manufacturing countries. Vietnam should take an active role in ASEAN efforts to pool resources and enhance the region's competitiveness by participating in AICO scheme. Another priority for Vietnam is to become part of brand-to-brand complementation (BBC) networks established by Japanese assemblers within the ASEAN region. Even in BBC or AICO scheme, Vietnam will have to compete with other countries.

Other measures Vietnam should pay attention are to simplify and unify its automobile registration procedures and documentation requirements. If the government does introduce local content requirements, it should provide incentives, such as extra local content points or tax benefits, to companies that meet local content targets ahead of deadlines. There is a need for continued efforts to improve infrastructure, including road development and the establishment of parking facilities. It is obvious that a country with such a big population base demands its own vehicle industry, but without committed long term investment it will remain just a dream for Vietnam.

Chapter 5

CONCLUSIONS

I. Key Findings

Vietnam is at the very early stage of development and in the process of economic renovation. The world economy is in the process of internationalization and globalization, which offers opportunities as well as challenges for economic growth of Vietnam. During the past fifteen years of renovation, Vietnam's economy has gained remarkable achievements, however this economy contains in it many factors obstructing the country's development.

Beside the existing weak fundamental background of Vietnam's economy, the on-going reforms are very slow, and some of them are unexpected successful. Market mechanism is not fully formulated in the country. Socialist components of the economy are still dominated. State administrative management at both central and local level is weak and inefficient. Bureaucracy and corruption are the pervasive phenomena. Some macro-economic polices, conducted by Vietnamese government, are the reasons for misallocation of economic resources, namely import substitution policy, capital intensive industry furtherance, picking winner, infant industry protection. The key industries have developed through very high levels of import protection in recent years and remain extremely inefficient: Motor vehicles, Motor cycles, Bicycles, Cement and Steel, Fertilizers, Sugar.

Protecting ineffective industry, the Vietnamese government spent money in ineffectively way and imposed costs on other sectors. In the result, many Vietnamese products are non-competitive in the international market. For example, there is a cost of industrial protection to the agriculture sector in Vietnam. The current quota systems affecting

imports of fertilizer has allowed domestic prices to be 70 percent higher than the price of imports from Indonesia, and 40 percent higher than the price of imports from Eastern Europe. This is to imposed direct costs of around US$38 million (Goletti, 1998) on farmers. Recent study (Van, 1999) showed that in comparison, removal of direct trade restrictions affecting agriculture (primarily rice export quotas) could lead to an increase in real farm incomes of around 5 percent. If industrial protection were removed, the total GDP would be higher by around 2.5 percent.

In sugar industry, import restriction is resulting in over-supply of sugarcane. Mealwhile the wholesale price of sugar is about 25 percent higher than the import price, and the effective rate of protection is around 90 percent. The latest analysis (1999) showed that trade liberalization would make sugar available at a 22 percent cheaper price, increase the real income by US$92 million.

The current macro and micro economic environment in Vietnam is not favourable for domestic productive activities as well as FDI activities. The decline of FDI inflow and low rate of FDI implementation in recent years are clear evidences. The Vietnamese government has not made use of all opportunities and positive effects that FDI can offer. Besides the positive contribution of FDI to Vietnamese economy, FDI activities even have negative impact on the economic development, such as external loan burden, trade deficit, high-price products are of the customers' choice.

Vietnam is a poor country, the domestic saving rate is small. The country's development is heavily relied on more domestic capital accumulation and external resources. Therefore, the efficient use of rare source of capital is very important for Vietnam. Any economic resource has its opportunity cost. Opportunity cost of an item is what you give up

to get that item. If the capital is invested in effective industry (e.g. the industry that Vietnam has comparative advantage), it will result in profit earnings, extra money wille be earned, saving capital will be availabe for next investment and other economic social expenses. Consequently, the country will get high economic growth. If capital is put in non-profit activities (for example, in capital-intensive industry in the short run), there will be no profit earnings, no extra capital needed for paying back investment capital, or for loan's repayment and especially for successive investment required for development. In the result, economic growth will not be observed, and new investment has to be based on more foreign loan. In turn, it will be more repayment burden on the economy latter.

In the context of the globalization, liberalization, and the world competition, by many economist, achieving high growth rate is much more important than the composition of growth. The size of a particular industry says little about its importance to the economy, and small sectors can be important for the growth of other sectors in the economy. A vital part of the new context is the need to improve competitiveness. Growth can be sustained only if countries can create new, higher value-added activities that hold their own in open markets.

II. Policy and Management Implications

There is an important role for government policies, but not in the earlier mould of widespread intervention behind high protected barriers. If TNCs were to operate in well-functioning markets and were to act as rational profit maximizing agents, there would be no need for policy intervention[20]. Rather, in a globalizing world economy, governments increasingly need to address the challenge of development in an open environment. While

[20] There may still be a case fir policy intervention if TNCs, because of their sheer size or market power, distort markets.

waiting for entering WTO, Vietnam can reduce gradually degree of protection. Protection policies should be phase out according to free market economy theory. Or more practically, in the short run, Vietnam may continue protect those only efficient sectors, which would grow healthy in the near future. But in the long run, Vietnam should follow "market principle", it means that Government should abolish all kinds of protection. While a nationalistic tendency to create "complete" industries in Vietnam is understandable, it will only be through international integration and cooperation that economic development will progress rapidly in Vietnam, especially given the lack of modern industrial techniques currently in use. However, that any form of industry furtherance must conform to the rules of institutions such as AFTA and the WTO.

The big policy questions are concerned with fostering an environment in which rapid accumulation – and efficient deployment – of human and physical capital can occur, and in which enterprises are encouraged to experiment with ways to improve factor productivity. A stable political environment and a sound macro-economic policy involving solid government finances, rational growth in money and credit, a manageable debt, relatively low inflation, and openness to international markets promotes growth. Institutions and infrastructure can positively constitute the business environment in which the enterprises compete.

To a large extent, an investment-friendly policy framework is also a development-friendly policy framework. On the question of how to improve the investment environment, the beneficial effects of domestic and direct investment and the efficiency of resource utilization can be raised, but this would hinge critically on improvements in the several areas: Improve the micro and macro-economic functioning of the country's economy and strengthening commercial and judicial institutions that provide stability and dependability to

all domestic as well as foreign investors. Priority in project licensing should therefore be placed on labor-intensive export-oriented projects, away from investment in capital-intensive import-substitution and domestic consumption industries. On the other hand, careful consideration must be made of the timing of investment, the state of international product supply and demand, and the feasibility of each individual project, and if need be, some form of furtherance provisions may need to be adopted over a fixed period. Such furtherance provisions can act not only to protect local interests, but also to entice foreign investment.

The role of FDI has become more and more important today, especially for developing countries, even for Japan and South Korea that did not pay much attention to FDI in the past. Vietnam faces fierce competition with other ASEAN nations to attract FDI flow. Since the Asian economic crisis, the neighboring countries have even accelerated the liberalization of FDI-related policies. Take Thailand for example, among the efforts to improve the FDI environment, Board of Investment (BOI) has tried to attract FDI by establishing themselves as a "one-stop shop for services". As a result, FDI inflow to Thailand increased from US$2,405 million (1997) and US$3,732 million (1998) to US$7,449 million (1999) (UNCTAD, 2000b, p.286). At the same time, FDI inflow to Vietnam continuously decreased from 1997 through 2000. Therefore foreign policy reform should be part of more general reform of investment policy directed at liberalization and rationalization. Vietnam has to investigate how the neighboring countries treat incoming FDI. With considering the forthcoming obligation for the WTO and AFTA, Vietnam need to make a drastic decision for hosting FDI. Many observations suggest that investment incentives or preferential arrangements are not necessarily the key, the improvements of

favourable investment conditions are more important. Foreign firms think more of the transparency, fairness, and predictability of FDI-related policies and administration.

Freer trade attracts FDI, and also the presence of foreign affiliates accelerates trade liberalization. Export-oriented foreign affiliates aggressively utilize the system of tariff exemption or reduction on imported parts and components for export products. FDI has effectively catalyzed freer trade. FDI flows, especially those directed to manufacturing sectors, promote spill-over effects, which are essential for foreign invested enterprises to contribute to the long-term productivity gains, leading to sustained growth in a host country. Cross-countries experiences suggest that a strong foundation for human resources (backed by sound education programs) tend to facilitate transfers of technology and management skills, and that more open trade and competition policies lead to greater technological and productivity gains from FDI.

Within the course of a decade, Vietnam's economy has made a decisive turnaround to demonstrate sustained growth in recent years. This has formed the basis for the country's greater engagement with the world community, and has paved the way for it to embark on a new program of industrialization and modernization. However, Vietnam enters this new phase in an extremely weak competitive position with many weaknesses. To ensure further development, it is crucial for Vietnam to implement a drastic reform, an another *Doimoi* program.

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