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# Manufacturing and Industry in Vietnam

## Three Decades of Reform

Do Duc Dinh



Strengthening Africa's economic performance



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### Contents

Executive Summary – Key Observations For Africa . . . . .	3
Economic Reform . . . . .	5
Industrial Transformation and Growth . . . . .	8
Industrial Transformation Under Doi Moi. . . . .	8
Main Factors Behind Industrial Growth . . . . .	13
The Changing Contributions of Various Entities . . . . .	14
International Integration. . . . .	14
Future Prospects . . . . .	15
References . . . . .	15
Appendix. . . . .	17

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## EXECUTIVE SUMMARY – KEY OBSERVATIONS FOR AFRICA

The experiences of many East Asian countries over the last 50 years have shown economic conditions of sustained growth, reduced poverty and gains in a number of human development indicators. African countries are often encouraged 'to look East' for lessons on innovation in economic policy and boosting manufacturing and exports as a means to achieve developmental goals. Many countries have taken those lessons to heart, implementing policies that aim to mirror East Asian success, such as setting up Special Economic Zones (SEZs), offering duty- and tax-free terms to export manufacturers, along with a range of other incentives on land and services. However, since many other countries are already doing this, it does not offer a special deal. The same applies to one-stop shops. African labour costs are no differentiator either, being generally no cheaper (and mostly more expensive) than Asian competitors, while the cost of corresponding services in Africa can be higher and less reliable. So the question becomes: what should we be learning from East Asian countries if it is not SEZs and one-stop shops?

Vietnam is a country that offers an interesting learning opportunity for many African countries. 2016 is the 30th anniversary of the implementation of the country's

Doi Moi Reform policy, a policy that saw Vietnam's gross GDP increase by nearly 30 times in the period between 1989 and 2014, from US\$6,3 billion to US\$186 billion.

Like many African countries, Vietnam faced the challenge of a low-skilled labour force. However, unlike many African countries in 1986 Vietnam had a population of around 60 million – a number that is far larger than the African average, even in 2016. The country was coming out of a time of devastating protracted conflict and faced the challenging task of rebuilding a war-torn economy. The attached Paper by Professor Do Duc Dinh provides a detailed internal analysis of the reform process with a specific focus on the policy effects in manufacturing and industry. The Doi Moi reform was a hybrid policy, it did not conform to any of the standard economic principles at the time but rather was a combination of policy maneuvers best suited to the Vietnamese context and leading to what Professor Do refers to as, 'the dynamic comparative advantage enhancement industrialisation strategy'. As African countries grapple with myriad development challenges, Vietnam affords a number of key insights into the catalytic impact of interventions which draw on states' comparative advantages.

### STEP-WISE POLICY IMPLEMENTATION

The development of Vietnam's 'dynamic comparative advantage' came about through concerted government effort. Policy was implemented in phases, with each subsequent phase of development responsive to issues that had come up previously, creating a process that favoured gradual adjustment and implementation as opposed to the blanket implementation of a static policy. Policy was introduced in 4 phases, the first phase aimed at post-war socio-economic recovery and the implementation of three main programmes dedicated to; food production and processing, consumer goods production, and exports production. This was implemented

alongside the adoption of the contract system in agriculture, the gradual reduction of subsidies, the expansion of the autonomy of industrial enterprises (mostly State-owned), and the promotion of exports. The second phase focused on monetary policy measures to stabilise the economy. The third phase focused on the development of the multi-sector commodity economy in order to help create a socialist-oriented market economy. The fourth set of policies aimed at opening the economy for trade through foreign direct investment (FDI), Official Development Assistance (ODA), and regional and international cooperation.

### MANUFACTURING POLICY

The Doi Moi reform placed significant emphasis on manufacturing and transforming industry within Vietnam. At first glance it appears that Vietnam's steady growth was dominated by the development of intensive manufacturing industries, but the data tells another story. Data from the World Bank shows that value added from manufacturing as a percentage of GDP actually fell from 22.4 per cent in 1986 to 17.5 per cent in 2014. This fall, however, was accompanied by a growth in the value added from industry as a percentage of GDP from 28.9 per cent in 1986 to 38.5 per cent in 2014, accompanied by an increase in exports of goods and services as a percentage

of GDP from 6.6 per cent to 86.4 per cent. Information that shows that even though Vietnam pursued an export-oriented manufacturing policy, this policy aimed at the development of low skill assemblage technologies as opposed to the development of high value, high skill industrial manufacturing. Whilst there is now a concerted effort to move Vietnam further along the value chain and to reduce the imports of production inputs, the initial focus on low skill, labour intensive manufacturing with dedicated programmes to improve skills created the economic position that Vietnam now finds itself in.

### INTERNATIONAL TRADE AS REGIONAL TRADE

Vietnam's strategy of opening the economy to FDI and increased international trade is one that holds particular significance for African countries. Vietnam has expanded multilateral, regional and bilateral commitments with international institutions, regional organisations, countries and territories and has become a signatory on a number of trade agreements since reform. What is interesting about these trade agreements is that a significant portion of the agreements has been made with

other ASEAN members as well as countries in the rest of Asia. As mentioned above, Vietnam provides limited value additions to the manufacturing process however, through a strategy of importing inputs from neighbouring countries and exporting finished goods, Vietnam has been able to grow its trade base. At present, the Asia-Pacific region makes up 70–80 per cent of Vietnam's foreign trade and FDI.

### SURPRISE WINNERS

There have also been a few unintended consequences of the Doi Moi reforms. The reform policy strongly supported the development of a domestic automobile industry. However, after 30 years of protection, the industry has failed to develop beyond importing spare parts for assemblage. Surprisingly though, the motorbike industry is thriving. Motorbikes make up 90 per cent of transport facilities in Vietnam and in 2015, there were 31 million bikes in use in the country, 60 enterprises involved in

manufacturing motorbikes and 5 million motorbikes produced a year – providing a compelling example of how policies designed to protect one industry can sometimes have unexpected but positive externalities.

*This executive summary was written by Nchimunya Hamukoma, Machel Mandela Fellow at the Brenthurst Foundation*

The main focus of this paper is the development of Vietnam's manufacturing sector since the Doi Moi economic reforms of 1986. However, in order to have a contextual grasp of industrial growth in Vietnam, it is necessary to have a solid understanding of the country's economic reform process in its entirety. This will be done by analysing the fundamental conceptual changes around industrialisation concepts from the 1950s to the mid-1980s and the transformation of Vietnam's industries since the start of the reform process in 1986.

This transformation was marked by the growth of various import-substitution industries such as electricity, mechanics and oil and gas; and the boom of competitive export-oriented sectors such as electronics, leather goods, wood products, food processing, garments and textiles, as well as the seemingly non-competitive automobile manufacturing sector. The Paper will engage with the role of various entities as engines of growth, focusing on State-Owned Enterprises (SOEs), the private sector, and industrial zones; as well as international integration, particularly the contributions of foreign trade, foreign direct investments (FDI) and Official Development Assistance (ODA). The final section will assess prospects for the further development of the Vietnamese economy.

## Economic Reform

The devastating decades-long Vietnam War ended in 1975 with the liberation of the South and the reunification of Vietnam. In the post-war period, the country continued its historical policy of a centrally-planned economy from 1975 to 1985. However, as a consequence of the war's destruction and decades of lost planning, Vietnam had an underdeveloped economy that was in serious social and economic crisis by the mid-1980s. In order to address the economic crisis, the government launched the 'Doi Moi' (renovation) reform process. Since then Vietnam has shifted from a centrally planned to a market – or more accurately, 'socialist-oriented market' – economy.

During the first five-year plan of reform, from 1986 to 1990, Vietnam recognised that the lack of food, consumer goods and exports were the most pressing problems to be addressed. The first major actions of Doi Moi were the implementation of three programmes aimed at food production and processing, consumer goods production, and exports production. These programmes were the beginning of the national adoption of a wide range of economic and industrial policies including import-substitution, export-orientation, resource-intensive and labour-intensive, heavy and light, and low-tech plus high-tech industries.

The first set of recovery policies were carried out to revive the economy from the damage that occurred during the war and the socio-economic crisis that arose in its aftermath. Along with the three

abovementioned programmes there was an adoption of the contract system in agriculture, the gradual reduction of subsidies, the expansion of the autonomy of industrial enterprises (mostly SOEs), and the promotion of exports.

Numerous policy measures such as inflation control, the reduction of money supply, and the 'basket' policy of price, wage, and monetary changes were adopted in an attempt to stabilise the economic environment. These policies failed twice in 1981 and in 1985 due to their 'big bang' approach, the hasty manner of implementation and/or poor preparation. However, at the beginning of the 1990s the policies started to generate good results on account of gradual adjustments and better implementation.

The third set of major policies focused on the development of a multi-sector commodity economy, which helped introduce the market mechanism.

The fourth set of policies aimed at opening the economy to competitive trade through FDI, ODA, and regional and international cooperation. The main measures implemented under this policy were the issuance of the Foreign Direct Investment Law in 1987 and the diversification and multilateralisation of the direction and form of foreign economic relations. The goal of this policy was to reverse the loss of traditional markets of the former Soviet Union and East European countries, the recapture of the regional market of Asia and the Pacific, the normalisation of relations with the United States, and the

expansion of Vietnam's international economic relations as a whole.

Vietnam adopted several concrete measures to promote industrialisation, including key investments in both hard and soft infrastructure; the development of various markets for commodities, capital and labour; the adjustment of macro-economic policies, in particular a stabilisation policy; the opening up of the economy to the outside world to benefit from the integration and globalisation processes; and investments to promote a healthy, well-educated and skilled labour force.

The implementation of these policies allowed Vietnam to overcome various social and economic crises, survive the collapse of assistance from the Soviet Union and a US embargo whilst holding relatively high growth rates and drastically reducing inflation from about 1 000 per cent in 1988 to 5 per cent in 2015.

**Vietnam adopted several concrete measures to promote industrialisation**

GDP growth rates were raised from less than 4 per cent per year during the period 1975–85 to 8–9 per cent per year during the first half of the 1990s, averaging 6 per cent per year over a period of almost 30 years from 1986 to 2014. As a result, the gross GDP increased 30 times in 25 years – from US\$6.3 billion in 1989 to US\$186 billion in 2014. It is expected that the Vietnamese economy will continue to grow at a rate of 7 or 8 per cent from 2016 to 2030.

Along with high GDP growth rates, the GDP per capita increased 20 times from roughly US\$100 in 1986 to US\$2000 in 2014, greatly contributing to the improvement of the living conditions of the people, the upgrading of Vietnam from a low income to a middle income country by 2010. This was supported by the attainment of several MDGs, the most impressive of which was the reduction of poverty from over 70 per cent in 1986 to less than 10 per cent by the end of 2014.

In the agricultural sector, the average growth rate was 3.9 per cent per year. Rice production alone increased three times from 16 million tons in 1986

to 45 million tons in 2014, changing Vietnam from a country facing food shortages and importing about 1 million tons of food a year to a food exporting country. In 1989, Vietnam exported 1.3 million tons of rice and by 2012 it had achieved a peak, exporting 7.7 million tons. Over the last 25 years, Vietnam has become a continuous exporter of rice, routinely ranking as the second or third largest rice exporter in the world. The growth of food production has helped in the reduction of deforestation, leading to a forest cover of over 42 per cent of the land mass in 2015. It has also pushed up the production efficiency in fishery processing and other marine products. Several other agricultural exports have also excelled, including cashew nut and black pepper. Notably, Vietnam has become the second largest exporter of coffee internationally. Vietnam boasts ten agricultural products that individually exceed export values of US\$1 billion a year. All agricultural exports together comprised US\$30.8 billion in 2014, amounting to 20.5 per cent of Vietnam's total exports.

After 30 years of consistent growth, Vietnam's agricultural model has been widely praised, helping to overcome food insecurity and poverty. The proportion of poor households has reduced from over 70 per cent during the mid-1980s to 6 per cent in 2014. And the percentage of undernourished fell from 46 per cent in 1990–2002 to 13 per cent in 2012–14 (*OECD Review of Agricultural Policies*, 2015).

**After 30 years of consistent growth, Vietnam's agricultural model has been widely praised, helping to overcome food insecurity and poverty**

The contribution of the service sector also increased substantially to 44 per cent of GDP in 2015. Tourism, for example, has been restructured to raise the quality of service through major improvements in facilities and the diversification of tourist offerings. In recent years income from tourists has increased annually by around 20 per cent and the number of international tourists hit 8.7 million in 2015. The aim for the coming years is to raise the

growth rate of the service sector to 7–7.5 per cent per year and the share of service in GDP to 45 per cent by 2020.

The period of reform has also been marked by an intensifying of international economic relations. During this period, Vietnam has expanded her multilateral, regional and bilateral commitments with international institutions, regional organisations, countries and territories, in line with international integration policies. This has been reflected in the establishment of diplomatic relations between Vietnam and 170 nations, including the normalisation of relations with the US, acceding to the WTO and joining ASEAN. In the reform period, Vietnam has signed over 90 bilateral trade agreements, nearly 60 agreements on investment incentives and protection, 54 agreements on double tax avoidance, and are currently developing trade relations with over 230 countries and territories. Vietnam has concluded eight Free Trade Agreements (FTAs), including the following six ASEAN FTAs:

- AFTA (All ASEAN members)
- ACFTA (ASEAN–China)
- AKFTA (ASEAN–Korea)
- AJFTA (ASEAN–Japan)
- AIFTA (ASEAN–India)
- AANZFTA (ASEAN–Australia and New Zealand).

There have been two bilateral FTAs between Vietnam and Chile (CVFTA), and Vietnam–Japan (VJEPA); finalised the negotiation phase with the Customs Union comprising Russia, Belarus and Kazakhstan; the FTA with South Korea, the FTA with EU, and the TransPacific Partnership – TPP). Under these FTAs, WTO and TPP agreements, most tariff rates have been reduced to at least 20 per cent and are set to reduce further to 0–5 per cent.

Trade is one of the most developed areas of Vietnam's foreign economic relations. Exports alone have been raised from half a billion US dollars a year during the mid-1980s to US\$165 billion in 2014, a 300-fold increase. The normalisation of relations with the US and Vietnam's admission into the WTO were pivotal in this rise. The structure of exports has been transformed to allow for the increased exports

of manufactured products, while reducing the exports of unrefined raw materials.

Foreign Direct Investments, (FDI) have played an important role in the development of the economy in general and industry in particular. During the 2011–15 period, registered FDI was US\$88 billion, while the realised capital was US\$58.5 billion. In 2014, Vietnam received US\$21 billion in FDI which made up 18 per cent of GDP, 46.3 per cent of industrial production, and 66.2 per cent of exports. FDI has created an estimated 1.7 million jobs.

Trade is one of the most  
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foreign economic relations

In recent years Vietnam has started to invest abroad. By 31 December 2014, Vietnam had invested in 930 projects overseas with the total registered capital of US\$14.85 billion.

Official Development Assistance (ODA) from 1993 to 2014 reached over US\$78 billion of committed capital, with US\$40 billion realised.

Vietnam is also one of the top 10 countries globally in terms of remittances received from workers abroad. Remittances have increased yearly, reaching over US\$11 billion in 2013 alone.

Integration into the Southeast Asian and the Asia–Pacific region has also proceeded apace, with the latter currently making up 70–80 per cent of Vietnam's total foreign trade and FDI.

The industrial sector has witnessed significant growth over the period, leading to an increase of the contribution of industrial and service sectors to GDP from 60 per cent to over 83 per cent in 2015. During the same period the contribution of agriculture to GDP has dropped from 40 per cent to less than 17 per cent. Accordingly, the share of agricultural labour in the total labour force also dropped from about 80 per cent to 46.5 per cent. This transformation clearly reflects the change of the economic structure oriented toward industrialisation and modernisation.

## Industrial Transformation and Growth

### *Changing Concepts 1950s Onwards*

Vietnam's industrialisation process has had two fundamental stages:

- 1950s to the mid-1980s, a heavy-industry-based strategy;
- mid-1980s to the present day, adopted a new strategy that combined industrialisation with modernisation in a complementary approach, or in the author's words, *the dynamic comparative advantage enhancement industrialisation strategy*.

After the official Declaration of Independence in 1945 and the regaining of peace at the Dien Bien Phu Battle of 1954, Northern Vietnam moved from a war economy to a time of peace and reconstruction, whilst continuing the liberation struggle in the South. During this period, a key task of North Vietnam was to industrialise the economy. In this context, the idea of industrialisation was characterised by the need to transform the agrarian economy that had over 80 per cent of its population living and working in agricultural and rural areas, with a GDP per capita of less than US\$100.

During the 1950s, like several other developing countries, Vietnam was highly influenced by the Soviet model which took the heavy-industry-based strategy as the only model of development without engaging with issues around the lack of comparative advantage, lack of capital, backward technologies and unskilled labour force. Most of the policy-makers at the time had over-assessed the internal factors and

had expected significant aid from the Soviet Union. They did not sufficiently engage with the complexities of managing three tough transitions all at once in a small and weak economy: the change from a war-torn economy to peace-time reconstruction; the transformation from a centrally-planned to a market economy; and the upgrading from an agrarian to an industrialised economy.

As a result of the rigid copying of the old Soviet industrialisation model and war-time destruction, the Vietnamese economy in general and industry in particular, were very poorly developed. Moreover, by the end of the 1970s and the first half of the 1980s, Vietnam fell into a deep social and economic crisis. The living conditions of most deteriorated, except for some speculators who benefitted from the instability and those whose living was relatively subsidised. These problems provided a strong impetus for the Doi Moi reform in 1986.

1986 also marked a vital 'reform of thinking', as Vietnam adopted new ideas of industrialisation, reflected in the concept of, 'industrialization, modernization': Vietnam would no longer be based solely on heavy industries; instead, it would be a combination of traditional industrialisation with modernisation, embracing traditional industries some of which had been developing since the 18th century, along with modern industries that were high-tech and required greater human capital in order to meet the new requirements of the globalisation process and the knowledge-based economy.

## Industrial Transformation Under Doi Moi

### *The Overall Development of Industry*

Though the concept of industrialisation was altered, the fundamental role of industry remained unchanged. Industrial growth towards a diversified structure that includes consumer goods, food processing, export products, and heavy industries continues to be identified as one of the most important tasks in the comprehensive social and economic development of Vietnam.

The change in models led to a remarkable development in Vietnam's industry: the average growth

rate of the industrial sector reached 9.4 per cent per annum through the period 1996 to 2014, though the last five have seen a slowing of growth to around 6 per cent and 7 per cent. The growth targets for industry and construction are set at 7.5 per cent per year for the years 2015–20. Recent forecasts predict that Vietnam may soon become a world centre of manufacturing for sectors such as steel, electricity, energy (oil, gas and coal), construction, mechanics, chemistry, electronics, garments, agricultural



and fishery product processing, mine and mineral processing.

The transformation of the industrial sector has led to a drop in the size of mineral industries as a share of GDP, while the share of manufacturing and processing has been raised by 60 per cent in 2015. It is planned that by 2020, industry and construction will make up around 40 per cent of GDP, of which manufacturing and processing industries will share 25 per cent, and manufacturing alone will make up 15 per cent.

The forecasts were made as a reflection of the development of several important and relatively large industries producing production tools, consumer goods and export products to service large energy and industrial plants. For example, 74 per cent of the equipment used for the construction of the Thái Nguyên Cement Plant was produced in Vietnam. Besides large and modern industries, handicraft and small industries have also grown significantly.

Meanwhile, industrial exports have grown quickly, making up 80 per cent of the country's total export of US\$165 billion in 2014. However, the majority of this growth has been made by foreign manufacturers based in Vietnam.

### *The Growth of Competitive and Non-competitive Manufacturing Sectors*

Vietnam has identified its most competitive manufacturing sectors as those with intensive low-cost-labour and assembly industries, including electronics, textile and garment, leather products, wood products, food processing, and the seemingly non-competitive sector of automobile manufacturing. Electronics and computer manufacturing in Vietnam have become increasingly attractive to foreign investors. Large companies like Samsung, Nokia, Sony, Canon, and LG have already invested and continue to invest large projects in Vietnam.

One of the fastest areas of growth for Vietnam's manufacturing sector in recent years has been *electronics and computers*, experiencing growth rates four times higher than the growth of industry as a whole. In 2014 alone, the export of electronics and computers amounted to over US\$35 billion. Most of the products have been produced with imported inputs, with local content only a small part of the overall production. With the export value of US\$30

billion in 2014, electronics are not only a big contributor to total exports but also play the lead role in the electronics manufacturing of ASEAN countries. Vietnam is currently planning to raise the export of electronics to US\$40 billion in 2017.

FDI enterprises play an important role here, making up one third of the total number of electronics enterprises in Vietnam and covering over 80 per cent of the domestic market. Samsung alone exported US\$20 billion last year and is expected to pass US\$30 billion a year in the coming few years.

Though they have created a large number of jobs, to date it's been low skilled labour such as assemblage, importing a large portion of spare parts and materials leading to low overall benefits. To address this, the government is currently planning to support the electronics industry with various new initiatives and technologies.

Industrial exports have grown quickly, making up 80 per cent of the country's total export of US\$165 billion in 2014

The export of telephones and spare parts has become one of the largest contributors to the growth of the country's total exports. The EU is the largest importer of Vietnam's telephones and spare parts, with US\$6.7 billion. Computer exports during the first eight months of 2015 were nearly US\$10 billion – again the EU was the largest importer at just under US\$2 billion.

The second largest manufacturing sector is the *garment and textile industry* with total exports of US\$24.5 billion in 2014, of which US\$15.5 billion were garments, US\$1.9 billion were textile thread, US\$340 million were technical cloth and US\$520 million was material. With a growth rate of 19 per cent in 2014 compared to 2013, Vietnam's garment and textile industry has been identified as one of the fastest growing garment and textile industries worldwide and was ranked as the 5th largest garment and textile exporter internationally.

The most important markets for Vietnam's garment and textile exports are the US with US\$10 billion, followed by South Korea and the EU.

At present, over 60 per cent of Vietnam’s garment and textile exports are to the US and Japan, members of the TPP. When the TPP becomes effective, Vietnam’s garment and textile tax rates to the US market will be reduced from 17 per cent to nearly 0 per cent, making Vietnam one of the countries to benefit most from entering the TPP. It is estimated that with the TPP, Vietnam’s garment and leather product exports may reach US\$165 billion by 2025. Without the TPP however, the figure may stay at US\$113 billion. In order to obtain those benefits, Vietnam needs to pass considerable challenges such as the high dependence on non-TPP members like China and Korea. At present, about 88 per cent of the materials used for Vietnam’s garment and textile production have been imported from foreign countries with a significant portion from non-TPP members.

During the past decade, there has been an increase in share of the local content in manufacturing

Though garment and textile production is on the rise, there are conflicting views about the sector. On the one hand, it’s a light industry with simple processing and assembly technologies, low value, low local content and high foreign dependency. But on the plus side, the sector has provided jobs for nearly 4.5 million people who may not have the skills to get into high-tech industries. Of these 4.5 million people, 2.5 million are workers of 6 000 factories with a total annual income of around US\$6.7 billion, a substantial contribution to the social and economic development of the country. Besides jobs gained directly from the garment and textile industry, the manufacturing sector has also provided about 2 million jobs for the indirect workers who get their earning from supporting industries such as logistics, transportation and other related activities.

During the past decade, there has been an increase in share of the local content, raising from 20 to 25 per cent of the total export value of garment and textile in 2000–01 to 49–50 per cent currently, with about ten times more domestic materials used

in the production of garment and textile exports. Additionally, a considerable amount of local materials have been exported, valued at about US\$2 billion a year.

Though there are still difficulties and challenges, foreign investment in the sector is growing. In 2014, nearly 20 FDI-funded garment and textile projects were registered; altogether FDI in the sector is over US\$2 billion.

In recent years, Vietnam has increasingly called for FDI to be directed to supporting industries, with the aim of raising local content up to 60–65 per cent and to increase domestic consumption above the current annual average rate of 10–15 per cent.

With significant growth over the last 20 years, Vietnam’s shoe and leather product manufacturing currently ranks fourth in the world in terms of total production

The third ranking sector is the *leather goods and shoe industry*. In 2014, this sector fulfilled the goal of US\$12 billion exports, passing the US\$10 billion mark for the first time and making up over 10 per cent of the country’s total exports. The growth rate of this sector in 2014 was 19.7 per cent, nearly three times over the growth rate of the whole industrial goods sector. Over 500 shoe and leather factories have created jobs for about 650 000 workers, 85 per cent of whom are women. With significant growth over the last 20 years, Vietnam’s shoe and leather product manufacturing currently ranks fourth in the world after China, India and Brazil in terms of total production, and third after China and Italy in value. Moreover, in 2014 the export of leather materials also surpassed US\$1 billion, adding leather materials to the ‘club’ of over US\$1 billion exporters.

The target for 2016 is 314 million pairs with an export value of US\$16–17 billion. The share of localisation for 2016 is expected to be between 60 and 65 per cent.

Of the 50 markets where Vietnam trades in leather products, the three largest markets are EU,

the US and Japan. In the coming years when the FTA with EU and TPP come into effect, the tax rates of Vietnam’s leather product exports to the EU will be reduced from 12.4 per cent to 0 per cent, and to TPP members from 3.5–57.4 per cent to 0 per cent. This industry also faces tough challenges, however. Nearly all its production has been in simple processing with 80 per cent of the materials and most machinery and equipment imported. The share of localisation is at 40–45 per cent, with most of the capital coming from the FDI sources, 90 per cent of the capacity belongs to foreign and State-owned enterprises. Productivity is low when compared to regional competitors with medium levels of technological capacity. At present, the levels of productivity are 1/35th of Japan, 1/30th of Thailand, 1/20th of Malaysia and 1/10th of Indonesia’s. Though it is the third largest manufacturing sector, Vietnam’s leather goods sector is based largely on low cost labour, with 77 per cent of all exports by FDI enterprises who capture the majority of the value-added benefits. In order to overcome these challenges, Vietnam plans to increase the local content to 80 per cent by 2020 and to raise the total export of leather products to US\$25 billion by 2025.

The fourth most competitive sector is *food processing* which has been well developed to meet both local and foreign market requirements. Today this sector contributes 20 per cent of GDP. The annual consumption of food products is estimated at around 15 per cent of the total GDP. The total export value of food products in 2014 was US\$30 billion. According to the forecast of the Industry and Commerce Ministry, from 2015 to 2016, Vietnam’s consumption of food will increase 5.1 per cent annually, reaching US\$29.5 billion a year, with per capita consumption of about US\$316 per annum.

The annual consumption of food products is estimated at around 15 per cent of the total GDP

As a result of the growing requirements and competitiveness in both domestic and international markets, this sector has great potential for expansion,

relying as it does mostly on domestic inputs, which now conform to international standards of safety. The potential for Vietnam’s food production is considerable, given the projected increases in world food requirements. At present, the main foods produced in Vietnam include beer, alcohol and other beverages; milk; vegetable oil; cakes and candies; and cigarettes.

The production of *beer, alcohol and other beverages* has developed quickly, making up 5 per cent of the total value of the whole industry providing nearly 40 000 direct jobs. Most of the enterprises in this sector have applied modern technologies and followed industrial scaling; some enterprises have been built up in order to fit directly into the ISO 22000 quality protection system.

As a result of the growing requirements and competitiveness in both domestic and international markets, the food processing sector has great potential for expansion

The production of *milk and milk products* has grown at 20 per cent per annum, in 2014 it produced US\$3.5 billion worth of goods and created 10 000 jobs. Milk products have been diversified to about 300 different products of increased quality and safety, meeting the domestic and export standards through modernised technology. However, the domestic production of milk and milk products only provides 25 per cent of the inputs required.

In Vietnam there are 37 enterprises producing *vegetable oil* with the capacity to refine 1.2 million tons of raw inputs to produce 1.129 million tons of refined oil a year. The majority of oil produced is used in domestic consumption, while a smaller portion is exported. Over 90 per cent of the raw materials are imported.

Another area of food production is *cakes and candies*. At present, there are over 30 large domestic enterprises and hundreds of small entities producing cakes and candies in Vietnam. The total production is over 100 000 tons a year with the annual growth rate of 10 per cent during the 2011–14 period, much

higher than the average growth rate of 3 per cent in Southeast Asia and 1.5 per cent in the world market. The income from cake and candy production is roughly US\$1 billion a year.

In general, Vietnam’s food industries reveal a high dependency on imported materials, technical barriers from importing markets, poor technologies in some areas, trademarks with limited brand recognition, low competitiveness, diversified allocation and small scale of factories (most of the 3 500 food enterprises have provided services as opposed to producing goods). To overcome these challenges, Vietnam is now preparing new policies to reduce taxes, increase incentives, and to enter into several FTAs to support food production enterprises.

Thirty years after adopting Doi Moi, Vietnam has been able to develop a competitive advantage in certain manufacturing sectors

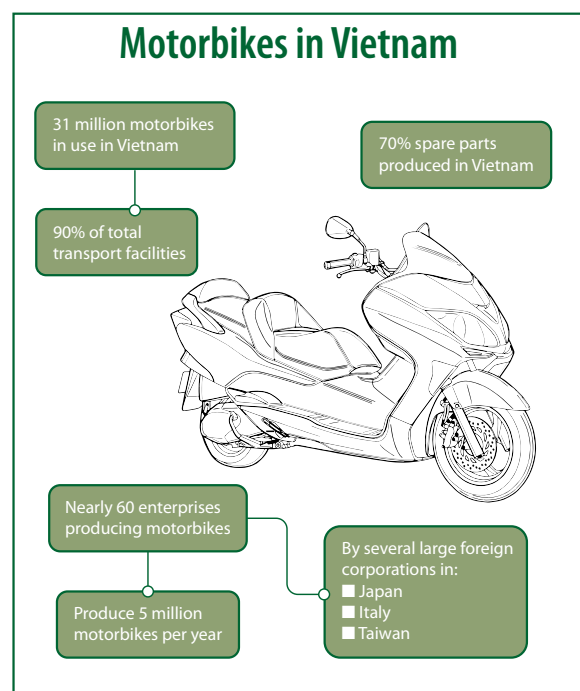
Other industries have been much less successful, not least the automobile industry. On 5 May 2015, *The Vietnam Express* published an article titled, ‘Vietnam’s automobile has failed’. After nearly 20 years of protection, the industry is still in its infancy with the majority of the work within the industry structured around importing spare parts for assemblage. It has not yet met its goals of localising at least 40–50 per cent of the production process, to meet 60–80 per cent of the local use and oriented to export vehicles and spare parts. However, at the time of writing, most of the objectives had not been met; local content was less than 10 per cent. The cost of production in Vietnam is higher than that of Thailand and Indonesia by about 20 per cent. Such high costs mean that Vietnam will be unable to compete with the vehicles produced in neighboring countries including other ASEAN countries when the tax rates are reduced to 0 per cent by 2018.

Aside from automobiles, there is some hope for motorbikes whose supporting industries have been better developed with about 70 per cent of the spare parts produced in Vietnam. The share of motorbikes used in the country is very high, making up 90 per

cent of the total transport facilities. In 2015, about 31 million motorbikes were in use. It is expected that the figure will increase to 33 million by 2020. There are currently nearly 60 enterprises involved in the manufacturing of motorbikes, including several large corporations coming from Japan, Italy and Taiwan. These enterprises produce 5 million motorbikes a year. However, the cost of producing a motorbike in Vietnam is higher than in neighbouring countries.

Though there are some pessimistic assessments about automobile manufacturing after 20 years of development, Vietnam is determined not to withdraw from the sector. In July 2014, the Vietnamese Government issued the new Strategy for Automobile Industry Development to 2025 and Vision 2035 with an aim to develop the industry to meet rising domestic requirements, participate in the world export market, and increase its competitiveness. The concrete targets are to produce 227 500 cars by 2020, 466 400 cars by 2025, and 1 531 400 cars by 2035. Export targets are set at 20 000 cars by 2020, 37 000 cars by 2025, and 90 000 cars by 2035. In order to achieve these targets, the government will provide greater support to the industry through the reduction of taxes, an increase in other incentives and stronger promotion of both domestic and foreign investments.

The above analysis shows that in order to develop an industry, Vietnam has had to overcome



a number of significant challenges – shortage of capital, unskilled labour population, a large share of imported raw materials, poor technology, low brand recognition and stiff competition, and other challenges. Thirty years after adopting Doi Moi, Vietnam

has been able to develop a competitive advantage in certain manufacturing sectors – and where it is failing, such as the automobile industry, it's determined to turn things around.

## Main Factors Behind Industrial Growth

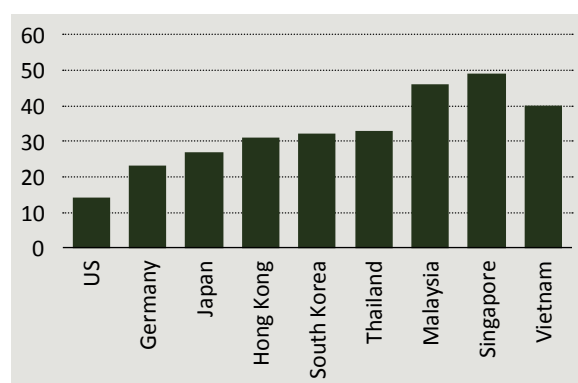
There are three main factors that have influenced the growth of Vietnam's industry: the Doi Moi reforms; the contributions of various entities such as SOEs, private firms, FDI and industrial zones; and international integration through several multilateral and bilateral schemes such as the WTO, FTAs and regional bodies.

### The Reforms

After 30 years of reforms, there is sufficient evidence to confirm that the most fundamental factor underpinning the growth of Vietnam's manufacturing sector has been the transformation of the economy from a centrally planned one to a market-based one. A transformation that has allowed Vietnam to remove a number of barriers to economic performance and to create a favorable environment for business development.

The first question often asked by a nation when they want to develop industry is how and where to acquire necessary capital to invest? The same question was raised for Vietnam during the 1980s at the start of the reform policy, with its status as a 'least developed country' and a GDP per capita of just US\$100. At the time, the only way for Vietnam to access capital was to raise domestic savings. Like other Asian late comers or late industrialisers such as Hong Kong, South Korea, Thailand, Malaysia and Singapore who raised their local savings up to 30 per cent of GDP (in the case of Hong Kong) or 50 per cent (Singapore) during the initial stage of industrialisation, Vietnam also raised domestic savings from 10 per cent of GDP during the 1980s to 40 per cent currently (see Figure 1). This high rate of savings plus the quick growth of exports and tourism, and the fervent pursuit of FDI, ODA, and remittances were typical features of Vietnam's capital formulation allowing the country to quickly acquire the necessary capital for industrial investment. In practice,

domestic savings, trade, foreign investment and aid have become the engines of growth for Vietnam's economy and industry.



**Figure 1: Gross domestic savings as % of GDP (selected countries, 2000)**

Sources: ADB, IMF, Recited from FEER, May 25, 2000, p. 66. See also gross domestic savings as percentage of GDP in 20 years (1975 and 1993) of Asian countries (including Hong Kong, Taiwan, South Korea, Singapore, China, Indonesia, Malaysia, Philippines, Thailand, India, Nepal, Pakistan, Sri Lanka), FEER, 24 November 1994, p. 46. \* Vietnam: 2014

Though the capital is important, it will not be efficiently used if the human capital is not sufficiently prepared. In Vietnam, the development of human capital was considered a decisive factor for social and economic development across sectors and including industry. As such, investment in science and technology has been raised yearly by 16.5 per cent, making up 2 per cent of the total government budget, though it is still far below the target of 2 per cent at GDP at its current state of 0.87 per cent of GDP. If we include the other sources of investment, the total social investment in science and technology was 1.3 per cent of GDP in 2015.

As a result, in 2015, skilled labour made up 50 per cent of the total labour force. Scientific and

technological potential has improved with the continued growth of both basic and applied sciences, particularly in the areas of agriculture, construction, health care, IT and telecommunications. The scientific and technological market has been developed, with an average transaction growth rate of 13.5 per cent per annum and huge increases in the number

of people working in scientific research. Healthcare has improved, greatly contributing to the increase in life expectancy from 50 during the 1950s to 73.5 in 2015, with a forecast for it to reach 75 by 2020. Such improvements have contributed to the development of industry.

## The Changing Contributions of Various Entities

Regarding issues of *ownership*, from the year of reform in 1986 to 1991 the Vietnamese economy was mostly owned by Vietnamese, with the public share accounting for 29.25 per cent and the non-public 70.75 per cent. By 1995, a new actor emerged: FDI. It started to play an important role in the economy, making up 6.30 per cent of GDP, rising to 15.5 per cent by 2005.

SOEs were responsible for over 40 per cent of GDP, whilst FDI made up 15.5 per cent of ownership, producing 18 per cent of GDP and 46.3 per cent of industrial production, the rest comprised domestic private and cooperative entities. This development shows that the State sector continues to lead the economy in heavy infrastructure and import-substitution industries, whereas FDI has dominated new and export-oriented manufacturing, while the domestic private enterprises and cooperatives perform mainly as small businesses employing a large number of people but having limited economic value.

In 2015, it has been noted that the performance of private domestic enterprises has improved, becoming more efficient and making a greater contribution to economic and social development, while SOEs have become less efficient and have started to make significant losses. Within this context, it is projected

that the role of the SOEs, private entities and FDI will change, with SOEs to be concentrated on the key areas of national defense, security and provision of public goods and services and the non-State sector is to be expanded to contribute about 39 per cent of the total social investment and 50 per cent of GDP; and FDI will be encouraged and given bigger incentives to positively contribute to the development of the infrastructure and supportive industries, renewable energies, new materials, electronics, information technologies, bio-technologies, plantation, husbandry, human resource training, high quality health care, and establishment of research and applied centers in Vietnam.

Another contribution to the growth of manufacturing in Vietnam has been the *industrial zones*. At present, there are about 300 industrial zones scattered in provinces across the country under government authority. These industrial zones operate in identified lots of land with constructed technical infrastructure and concrete legal regulations to ensure the proper economic, social and environment goals. The small zones are referred to as industrial clusters. The contribution of these industrial zones to total industrial production and export has been raised from roughly 20 per cent in 2000 to about 50 per cent currently.

## International Integration

As analysed earlier, Vietnam's multilateral, regional and bilateral commitments have created a favourable environment for the development of not only trade, investment and ODA, but also tourism, remittances and stocks. Foreign trade, investment and ODA

have truly become engines of growth for Vietnam's economy and industrial sector.

As a result of the expansion of international integration, Vietnam's commodity exports have increased in rank from 50 in 2007 to 34 in 2014 in the world market, imports from 41 to 32, and

service imports and exports from 59 to 54 in the same period. The development of industry, trade, services and other sectors has created nearly 13 million jobs for Vietnam between the year it joined the WTO (2007) to 2014. Moreover, during this period Vietnam has sent 694 000 labourers to work abroad, positively contributing to the reduction of unemployment and the earning of foreign exchange.

International integration has created challenges for industry such as the pressure to adopt high

international standards of labour, quality, cleanliness, environmental protection and technological processes. However, these challenges can also be viewed as opportunities that help Vietnam improve capacity.

In short, international integration has created more opportunities than challenges for Vietnam. In the next few years, as the commitments of the FTAs and TPP become effective, most of the tariffs will be reduced to 0 per cent, providing new opportunities but also new challenges, too.

## Future Prospects

To build on current successes, Vietnam is planning to obtain an average GDP growth rate of between 6.5 and 7 per cent per annum during the period of 2016–20, raising the GDP per capita to US\$3 200–US\$3 500 by 2020. To that end, the need for annual average social investment will increase from 32 per cent to 34 per cent of GDP.

The structure of the economy will be transformed to increase the combined contribution of industry and service sectors to over 85 per cent of GDP. To achieve these growth rates, the average growth rate of industry and construction will need to be at 7.5 per cent per year, with the share of these two sectors rising to 40 per cent of GDP by the year 2020, the share of manufacturing and processing to 25 per cent of GDP, in which manufacturing makes up around 15 per cent.

The service sector is expected to grow at 7–7.5 per cent per year, to a share of 45 per cent of the GDP by 2020, with priority given to high-tech and high value-added services. The average growth rate of agriculture is expected to be 3–3.5 per cent per year. There are plans to develop the ocean economy, particularly in the areas of oil and gas exploitation and

processing, sea ports, building and repairing ships, transportation, marine product exploitation and processing, logistics, and ocean tourism. There are also plans to build the coastal economic and industrial zones connected to the development of coastal cities. The development of the ocean economy is closely linked to the protection of national sovereignty and territory and the raising of living conditions of the inhabitants of islands and coastal areas.

In the Strategy for Industrial Development to the Year 2025 and Vision to 2035, Vietnam has planned to develop an industry with the major parts covering the high-tech sectors which produce products of international standards by the year 2035. Three sectors to be given high priorities are manufacturing and processing; electronics and telecommunication; new and renewable energies. From now to the year 2025 new and renewable energies will include wind and sun energies, and biomass energy. After 2025, atomic energy will be developed for peaceful purposes. Earth and ocean wave energies will also be developed during this period.

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## Appendix

Goals of Vietnam's Industrial Development to 2020 and Vision to 2030:

1. Value added growth rates to 2020: 6.5 per cent/year; for 2021–30 period: 7.5–8.0 per cent/year.
2. Production growth rates to 2020: 12.5–13.0 per cent/year; for 2021–30 period: 11–12 per cent/year.
3. Share of industry and construction in GDP to 2020: 42–43 per cent/year; to 2030: 43–45 per cent.
4. Share of manufacturing and processing in total industrial production to 2020: 85–90 per cent; share of high-tech industries in GDP in 2020: 45 per cent; in 2030 the successive rates are 90–92 per cent and over 50 per cent.
5. Energy Elasticity Index/GDP in 2015: 1.5 per cent; in 2020: 1 per cent; after 2020: <1.0.
6. Average growth rate of industrial air pollution is to be maintained at 4–4.5 per cent.

Ten industries to be rebuilt:

1. Mechanics and metallurgy.
2. Chemical industry.
3. Electronics and information technology.
4. Textile, garment, shoe and leather product manufacturing.
5. Agricultural, forestry, marine product, food and beverage processing.
6. Construction materials production.
7. Mineral exploitation and processing.
8. Electricity.
9. Coal production.
10. Oil and gas.

*Source: Vietnam's Industrial Development Strategy to 2025 and Vision to 2035.*