1 − 2

Some Problems about Developing Viet Nam Industry in the Period up to 2010 and 2020

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Currently, Viet Nam Government is developing a Strategy for socio-economic development in the new period up to 2010. This strategy for socio-economic development in the new period addresses to all socio-economic fields of the country, of which industry has a particularly important position. This paper is designed to exchange some aspects related to development of Viet Nam industry, problems on actual situation of development, trend and policy environment for industry development... Beside said issues, we try to put forth some suggestions and recommendations on the viewpoint of steering, selecting strategy for industry development in the future.

1. Viet Nam industry - actual status and problems

(1) Outline of actual development status - Trends of development

1) General situation of development

(a) Industrial growth

For recent years, Viet Nam industry has obtained significant achievements, contributing to promote economic growth due to bringing into play comparable advantage in resources exploitation and workforce utilization.

Proportion of industry in GDP from 21.86% in 1995 has increased up to 26.71% in 1998 and 29.05% in 1999 (if including construction, this proportion is 28.76%, 32.49% and 34.49% respectively); while proportion of agriculture has declined respectively from 27.18% in 1995 down to 25.78% in 1998 and 25.43% in 1999.

Growth rate in recent years has attained 12.7% per annum on average. Industry which is an area directly impacted by economic crisis in the region. still maintain growth rate at 10.5% in 1999, a bit lower as compared to previous years (14.2% in 1996, 13.8% in 1997 and 12.5% in 1998). It is expected that a higher growth-rate can be attained in the year 2000.

Industry has contributed an important part in export value, accounting for nearly 60% in gross import turn-over of our country. Export products with high value of turnover are: crude oil, textile and garment, processed farm-products. Recently, export turn-over from electronic components has reached more than USD 500 million.

(b) *Involvement of foreign direct investment (FDI) and industrial development , industrial parks development*

FDI currently represents nearly 32% of total invested capital for development of the whole society. Of which investment to industry accounts for 61% (including oil and gas), service industries nearly 17%... FDI activities have created a lot of new production capacities, new industries and trades, new products and technologies such as: oil and gas exploitation, steel and cement production, assembly and manufacture of automobiles, motorbikes, electronic goods...

In 1995, the sector with FDI capital has created 25% of product value of the whole industry sector, this value has increased by 32% in 1998 and 34.7% in 1999. With a growth rate of 22.3% per annum for the 1995-1999 period, contribution from FDI sector in product value of the whole industry will be raised in upcoming years. This sector currently accounts for 100% in terms of crude-oil exploitation, 70% of production and repair of motorized vehicles; 49% of household electronic appliances; more than 50% of steel; 14% of chemical products of the whole country...

FDI increasingly contributes to export operations for industrial products (crude oil, electronic components/ products, textile and garment products...), contributing thus to improvement of trade balance and payment balance of Viet Nam. In addition, it contributes creating more job, training labor staff and raising income for laborers.

(c) *Development of industrial parks*

Up to November 1999, there have been 67 industrial parks (IP), export-processing parks (EPP) and high-tech parks (HTP) established in 26 provinces and cities (immediately under central Government) with a total area of 10,492% hectares (ha) in initial stage, with infrastructure investment up to USD 400 million and VND 840 billion, not including Dung Quat IP with 14,000 ha area (see details in attached tables).

Along with FDI involvement, operations of IP in recent years have contributed to promote industrial development, increase GDP, shaping industrial centers associated with urban development, creating a pace of restructuring towards increasing proportion of processing industry for export and distribution on domestic market. At the same time, IP also contribute to creating more jobs, training managerial staff and high-skilled workers, implementing industrialization, narrowing the gap between various parts of the country.

Technologies of businesses in IP are of rather high level, among them there are a number of enterprises who have high technologies (Fujitsu, Roze Robotech, Mabuchi Motor,...) plus a good management, these enterprises have good competitiveness in global market. So, export production capacity of enterprises in IP represents more than 50% as compared to the whole FDI sector and will be increased in oncoming years.

2) Situation and trend of development of groups of the industry sector

(a) *Exploitation industry:*

In recent years, exploitation industry has developed strongly, of which mainly the oil and gas exploitation industry plays an important role, contributes to the start-up of national industrialization process. Until now, exploitation industry has occupied about 14.4% of gross output of the industry sector, particularly oil and gas industry represents over 12%. Crude-oil production reached more than 15 million tons in 1999, export obtained about USD 1.9 billion, contributing about 16.5% to export turnover of the whole country. In upcoming years, this natural resource is increasing, particularly gas, enabling the development of associated processing industries to create a source of raw materials for domestic production and exportation. Particularly, program of complete development ranging from gas exploitation, transport to processing is opening a development prospect for many industries, particularly power-supply and a number of chemicals and fertilizers industries. At the same time, it promises a development of many areas, particularly in Mekong delta such as Ca Mau, Soc Trang...

Table 1 Some products of exploitation industry

Products	Unit	1990	1995	1999[1]
Crude oil	million tons	2.70	7.60	15.00
Natural gas	billion m^3	-	0.25	1.101
Coal	million tons	4.60	8.30	0.00

Source: National Bureau of Statistics and Ministry of Planning and Investment

(b) *Processing and manufacturing industries*

Proportion of processing and manufacturing industries has occupied nearly 80% of industrial output value; their technologies have been gradually renovated in some industries to raise competitiveness oriented towards export.

- Processing industries that use raw materials form agriculture, forestry and fisheries accounts for a highest proportion in processing and manufacturing industries, about 33 - 34% of gross industrial product value. Many export products of high export value and competitiveness in the regional and global markets have been created such as fishery product, rice, coffee, cashew-nut, tea... However, this industry deals only with preliminary/ rough processing, mainly export raw materials. Raw materials of farm-product going through processing represent only 30%, the remainder is brought to market under the form of fresh products. This industry has not yet developed strongly to contribute to re-division of labor in agriculture oriented towards

[1] 1* Non-official data

industrialization. In recent years, labor structure between industry and agriculture has almost no change. A number of products which our country has comparable advantage such as export fruit and vegetable have not yet been developed to the utmost of potential.

- Labor-intensive industries involving a lot of laborers such as textile, garment, leather-shoes accounting for nearly 13.3% (1999) of industrial product value, have contributed a large value of export turnover. Two industries of textile and garment have reached export turnover of about USD 1.7 billion in 1998. If including the leather shoes industry, export turnover reached nearly USD 3 billion, ranking the second in exports, after export farm-products. In recent years, this export processing industry has been developed, creating more jobs for the society and distributed in many parts both in urban area and some rural areas. These are industries which Viet Nam is having comparable advantages in terms of human resources with low wages and markets such as EU, the United States and Japan. Garment industry of Viet Nam currently has exported its processed products to more than 40 countries and has involved many FDI projects (over 100 projects). However, at the present, its exports are mainly under the form of contractual processing with low added value. Internal association links are still weak, most fabric to be processed are brought from overseas, domestic fabric supplied to exports is of small proportion, less than 10%. The main reason is poor technology that results in quality not up to standards. On the other hand, another reason is bad marketing qualification which requires to recourse to its overseas partners (who award contracts for processing work). Investment environment as well as business environment is still in incompetency, not enabling to create motive force for development of small and medium businesses and the private sector.
- Mechanical industry and electronic and IT industry are high-tech industries, involving many employees, particularly high-skilled workers. In recent years, assembly industry has been developed such as assembly of cars, motorbikes and electronic appliances. This is an industry involving a lot of manpower at higher technical skills. However, it is only in the first stage, not yet creating facilities to manufacture components and accessories inside the country, associated with assembly industry, creating a network of small and medium businesses linked with large assembling firms, as a result, its effectiveness is not high, not establishing yet a labor division with a view to sustainable development and raising competitiveness in regional and international market.
- High-tech industries tends toward an industrial restructure conversion from labor-intensive industries with low technology to labor-intensive industries with high technology. These include electronic and IT industries, mechanical engineering industry developed towards the orientation of domestication of components and accessories for assembling industry, including engines of various sorts... Electronic and IT industry, commenced with assembly, has involved investment

to a number of production facilities for components and equipment such as circuit, cathode-ray tube, digital PABX... Software industry also starts to develop, firstly software applications. IT program has been developed in the whole country, firstly in management and accounting systems. Currently, high-tech parks have been commenced with building in the two Northern and Southern regions, so as to associate R & D with production practice and training high-skilled human resources.

- Small and medium industrial businesses play an important role in processing and manufacturing industries both in long term and in the next future. If small and medium enterprises, as defined according to temporary criteria promulgated by the Prime-Minister, are those who have a capital under VND 5 billion or the number of employees under 200, then nearly 90% of businesses in the processing and manufacturing industry are classified as small and medium businesses. Small and medium enterprises represent a largest proportion in food processing industry, textile and garment industry, leather shoes industry, following are mechanical engineering, electronic engineering, mainly including assembling and manufacturing facilities for components and accessories. In recent years, small and medium businesses (SMB) in the processing and manufacturing industry have been developed, particularly in private sector, under the form of company with limited liabilities. SMB sector has generated about 31% of industrial product value while their technological and managerial qualification is low and their competitiveness is weak. Association links between SMB and large enterprises have not yet established. Business and investment environment for SMB, particularly in private sector still have a lot of gaps particularly administrative procedures, not creating an incentive environment for SMB to have a long-term business strategy.

Table 2 Some products of processing and manufacturing industry

Product	Unit	1990	1995	1999[2]
Rolled steel	Thousand tons	101	470	1223
Diesel engine	Unit	4470	4217	15553
Cement	Million tons	2.50	5.83	10.38
Chemical fertilizer	Thousand tons	354	931	1119
Fabric	Million meters	318	263	317
Knitted wear	million products	29.0	28.0	29.6
Garment	million products	125	127	305
Paper	thousand tons	79	204	338

Sources: National Bureau of Statistics and Ministry of Planning and Investment

[2] Non-official data

(c) Power and water supply and production industries

This group of industries is regarded as infrastructure for industrial development, therefore they have been given proper concern for investment and development. Growth rate in recent years has reached nearly 13.7% per annum on average. Regarding electricity, a source combination of hydropower and thermal power, particularly thermal power using fuel gas, so far has reached an output of 23.8 billion KWh (in 1999) and is expected to reach 25-27 billion KWh by the year 2000. Electricity network has been developed and invested to provide power-supply for important economic areas including rural areas and event remote areas. Water resources have received investment to increase water-supply for urban areas and industrial parks.

3) General conclusions:

Industrial development in the past years has obtained a lot of achievements, contributing significantly to economic growth, however generally it remains in a low starting level, with weak competitiveness and many challenges in integration into regional and global market in a liberalized environment. Some points of assessment are as specified:

- Competitiveness of industrial products as compared with other countries in the regional and global market in terms of quality, cost-price, term of delivery and post-sales service. The most typical index on competitiveness is low labor productivity, high investment cost, large material consumption input, and weak management qualification that have reduced comparable advantages and competitiveness. Most industries require the Government's protection. In addition to customs measures, it requires to maintain a lot of non-customs measures such as limiting quantity, issuing quotas...
- Most technologies in industries are old-fashioned, which constitute a reason for limited competitiveness. Rate of renovating technologies reached only 7-8% per annum. Possibility of technological transfer through foreign investment is not large. Endogenous capacity for technology is not up to requirements; R & D have not been associated with production and is not able to meet requirements of production, on the contrary, production facilities have not ordered goods for R & D institutions. High-tech industries develop slowly, unable to create effects to raise labor productivity and product quality of industries and other trades of national economy including social labor productivity. Human resources meeting requirements for high-tech industries development are in shortage and limited in qualification, to take the initiative to receive technological transfer from overseas.
- Low industrialization level is reflected through rate of consumption for a number of products such as power, iron and steel, cement... which is far much lower compared to other countries in the region and industrial nations. The box below shows a comparison on power consumption per capita in Viet Nam as compared to a number of elected countries.

- Food processing industry plays an important role in processing raw materials from agriculture, creating new labor division in agriculture and countryside. According to evaluation, at the present, raw materials from agriculture only accounts for nearly 30% to be brought into industrial processing. Basically, it is rough processing, preliminary processing or preservation, and it is essentially an export of raw material products such as chilled sea-products, coffee, rubber. Intensive processing percentage is low. Turnover of industrial exports represents a major part of exported raw materials such as crude oil, mineral, raw materials from agriculture and fisheries. This situation limits contribution of added values, creating more jobs, and cannot raise commercial values of raw materials and farm products.
- Percentage of creating added values through industrial processing is still low, typically as some processed exports only gives back manpower cost at a low level, and raw materials are mainly to be imported. According to detailed data, it is the textile and garment industry which reaches a big turnover of more than USD 1.5 billion in 1997, but quantity of imported raw materials and other input materials amounts up to 80% of export value.
- Mechanism, organization and environment for development still have many gaps. The sector of state-owned enterprises holds currently big production facilities and key industries, but production efficiency is not high and competitiveness is weak. Environment for developing private industrial sector despite many improvements have not yet truly created motive force for development and this sector itself is still small and lack of competitiveness.

Average power consumption per capita in Viet Nam as compared to other countries is as follows:

• Viet Nam	225 KWh per capita
• Laos	63 KWh per capita
• Philippines	475 KWh per capita
• Indonesia	355 KWh per capita
• Malaysia	2,254 KWh per capita
• Thailand	1,164 KWh per capita
• Singapore	7,819 KWh per capita

(2) Government's solutions implemented for industrial development

1) Adjustment of institutions, Macro-economic policy

In recent period, during implementation of the strategy for Socio-Economic Development for 10 years 1991-2000, the Government has implemented a wide range of measures of adjustment of economic institutions and macro-economic policies. These reforms have create significant motive force for development of the whole economy as well as for industrial development.

Institutions and policies of economy are adjusted in the key directions as follows:

(a) Confirming and creating institutions of market economy with the State management and socialism-orientation. This is a decision that creates a great change in all socio-economic activities.

(b) Implementing consistently the policy of multi-component economy development. This policy solution has expanded conditions to mobilize resources for development and making the most of endogenous strength, enabling enterprises, particularly industrial enterprises, to have opportunities for development.

(c) Creating a complete set of elements of market economy for economic activities.

2) Adjusting economy structure and investment structure

The Government has undertaken to study on adjustment of economy structure in the orientation of promoting strong development of the area of industry and service from the overall aspect of the national economy.

Particularly for industry, policies are orientated to the development of industries with development potential to create high added value, creating more jobs, expanding export market for industrial goods to create a spring-board for industrial development. We may say that, economy structure as well as industry structure are adjusted in the orientation toward export, multi-lateral diversification in economic activities in general and industrial activities in particular.

Solutions for adjustment of economic structure has been implemented by the Government via adjustment of investment structure, re-allocation of resources directly from the State-budget and indirectly through policy tools so as to mobilize and allocate social investments.

Adjustment of economy and investment structure has created a rapid development of industry in recent period. However, this work has been done not much and many issues require to be deliberated both in methodology and solutions as well as tools that the Government may use to manage economy in general and develop industry in particular.

Table 3 Adjustment of investment structure for capital construction (in percentage)

	1990	1995	2000
Total social investment			
• Investment to economic infrastructure			
• Investment to social infrastructure			
• Investment to economic infrastructure			
• Post and transport........			
• Agriculture			
• Industry			

Source: National Bureau of Statistics and Ministry of Planning and Investment

3) <u>Strengthening legal basis and ensuring law effects</u>

- Developing and formulations basically law framework, promulgating laws and ordinances of various sorts, particularly as: Law on Promotion of Domestic Investment, Law on Foreign Investment, Businesses Law...
- Conducting admistrative reform in the orientation toward improving administrative procedures, qualification of staff in apparatus of state-management to secure implementing well socio-economic development policies in general and industrial development in particular.

4). <u>Renovation of state-owned enterprises</u>

One of important issues that the Government has implemented to raise competitiveness of Viet Nam industry is restructuring and renovation of state-owned enterprises. This sector holds now most assets and technical human resources of the national industry and plays a steering role in economic components.

Renovation of state-owned enterprises in general and industrial enterprises in particular is designed to increase autonomy of enterprises, raise competitiveness focussing on the followings:

- Renovation of business control mechanism, creating autonomous rights for enterprises, ensuring rights of juridical person operating and existing under the Law.
- Reorganization and streamlining of state-owned enterprises, promoting privatization/ equitization, strengthening financial auditing of state-owned enterprises.
- Developing a number of corporations into strong groups in a number of industries.
- Implementing measures of diversification, conversion of ownership to raise efficiency, reducing quantity and proportion of non-efficient state-owned enterprises.
- Bringing rapidly stock-exchange market into operations to mobilize domestic funds.

Steering idea for conducting the reorganization of state-owned enterprises (SOE) is to lay hold important and efficient SOE, giving priority to solution of privatization/ equitization, promoting the application of solution for ownership conversion such as selling, package contract or leasing small SOE.

During renovation of SOE, 18 corporations have been set up. The establishment of corporations has not yet achieved the target to form strong economic groups but it seems to be "an operation of addition of small businesses". Effect of these groups is not significant because no financial capacity is available as well as other capacities are still limited. Some opinions are that corporations cause more difficulties for member-companies in business operations, and reducing their business autonomy.

(3) Issues on environment of industrial development policies

During a long-time period, since the sixties, Viet Nam Government has established a general policy of industry in the orientation towards "giving priority to develop heavy industry in a rational manner on a basis of agriculture and light industry development...", to form an industry with complete structure, enough strong to provide physical and technical infrastructure to national economy through investment development directly from the State-budget.

After renovation, our economy is shifted into socialism-oriented market mechanism. Industry policy has seen many changes. Industry policy has been oriented to promote the development of industries creating much added values, export-oriented, increasing accumulation, resolving urgent problems of the society etc... With regard to development management, industry policy for DOI MOI (renovation) period has been oriented to strengthening the autonomy of enterprises, limiting subsidies (for SOE) and creating favorable conditions for private businesses development.

However, for many years, industrial development policy generally tends to invest to some key industries and concentrated much on public sector (sector of SOE), but the sector of small of medium businesses (mainly private sector) has not yet a good environment for development.

Practically, it is shown that, in principle, target oriented to a nation with enough strong industry is a proper objective but it is a long-term objective and generally it requires to be in line with economic potential of the country. Started from such an objective and orientation of industrial policy, for many decades, even in the renovation period, the industrial development has not been actually realized.

So far, policy environment for industrial development remains with many problems unsolved. Some big problems about policy environment for industrial development exist as follows:

- A set of policies for long-term development of industry posed in general development circumstances of the whole economy in new conditions has not been developed in a complete and perfect manner.
- Protection of domestic industrial production remains with many disputable issues.
- Role of the State in economic development in general and industrial development in particular has not been clarified about: (i) Role and scope of the public economic sector as well as scope of intervention by the State in economic activities in general and industry in particular (ii) Which tools of indirect policy the State must develop and use for management of the economy and the industry...
- System of policies for development of related industries and fields has not been developed in a complete and orchestrated manner on a selective basis, for instance: (i) development of human resources (ii) development of technological capacity: ensuring the association of scientific and technological development with industrial development, industrial properties and market mechanism for development of technological capacity and applying technologies into industry.... (iii) a number of markets of various kinds have not been created...

(4) Industry - commerce relationship in industrial development at the present time

Indeed, trade policies have a great impact on industrial development. Trade policy is designed to create a status of market facilitating the industrial development and ensuring effectiveness of the distribution of production factors such as labor, capital, land... Commercial environment for Viet Nam's industry development has many significant changes that has created both new opportunities and challenges for development of Viet Nam industry.

Viet Nam has implemented a policy of open-door economy and integration with the outside world through joining ASEAN, APEC and is asking for joining WTO. Commitments to a process of customs barrier lifting on the way to participate in AFTA up to the year 2006 are being implemented. Non-customs barriers limiting import-export have been gradually removed in recent years.

Trade policies oriented to integration into regional and global economy have created new opportunities and challenges. Opportunities are being opened for increasing investment, expanding market for product distribution as well as participating in production cooperation in the region and in the world for industrial development.

In the past years, along with protection of domestic production, export-oriented trade policy has been also implemented. Many incentives for exports have been implemented such as tax reduction, simplification and improvement of procedures, enabling enterprises to export directly, establishing export-assisting fund... policy of multi-lateralization and diversification, expanding export market are being implemented. The Vietnamese-American Trade Agreement recently signed also opens prospects for industrial exports.

Industry has an increasingly important position in export. However, export efficiency should be considered and given incentive policies.

Due to weak points of the industry, domestic industrial products have not yet a competitiveness enough in the global market, currently there are many disputable problems around trade liberalization. There are opinions that it do require to maintain the policy to protect a number of industries and industrial products in a certain term without breaking international conventions. Integration into regional and global economy compels enterprises to strive for raising themselves without prolonging the protection excessively. Government's measures for protection in the nearest future should be regarded as temporary solutions particularly for creating important and leading industries in the process of national industrialization and modernization.

Another opinion is that it requires to promote rapidly and immediately the process of liberalization, because only this that compels enterprises to orient towards business in goods and services with competitiveness. Protected businesses will not be able to become enterprises with competitiveness in world's markets.

Experiences show that there is no absolute trade liberalization. During trade globalization and liberalization, many nations do have necessary protection measures (indeed they must comply with international practice and rules) for a number of production fields and industries. The problem posed here is: What are to be protected? How? and When? while ensuring the implementation of commitments to integration and liberalization as well as the development of industry in particular and the economy as a whole.

(5) Potential for industrial development - advantages and opportunities to make the most of advantages in development.

During renovation years, Viet Nam industry has obtained considerable achievements, creating basis for further development. However, prerequisite factors for industrial development are still abundant, which are required to be grasped to make the most of our endogenous strength combined with external factors for a long-run vision of development of industry.

First and foremost, Viet Nam has a lot of mineral resources such as oil, gas, coal, iron ores and many precious metals. Our country's resources are diversified but, for the most part, of not big size, and it is impossible to develop our industry relying chiefly on exploitation and export of natural resources.

Trend from recent decades shows that economy of raw materials is increasingly separated from economy of industry due to impacts from scientific and technological advances creating new materials. Many nations in the world with their major income from export of natural resources and interim products cannot change their poor and backward fate.

In spite of that, it should be confirmed that natural resources for industrial development constitute an advantage and valuable natural assets, the problem posed is: how to exploit them efficiently and when? for what purpose? These are questions requiring to have solutions. As compared to other countries, it is possible to create initial accumulative capital for industrial development and it is a necessary condition to develop key industries and other involved manufacturing industries.

Viet Nam has 3000 km of sea-coast, regarded as an important factor, a valuable natural resource for industrial development, particularly for export industries and heavy industries as well as for sea-resource exploitation industries. With a system of sea-ports, particularly deep-water ports that have been planned and under construction and development, it is an important factor to promote industrial development, creating opportunities for involving foreign investment and as a entrance gate for exchange with other countries in the region and in the world.

An important and determining premise for industrial development is human resource. Viet Nam has a young labor force, among them a major part has graduated from high-school even in rural areas. This force has a rapid perceiving capacity and creativeness. Up to the year 2000, there have been about 7.2 million workers with technical skills, accounting for 19.5% laborers being employed.

Hundreds of universities, colleges and vocational training centers have been founded across the country. This is a basis to provide trained human resource to various industries and trades, creating conditions for absorbing new technological and scientific advances to adapt them and create technologies of Viet Nam.

In a long run, in the trend of the scientific and technological revolution which is taking place, human resource with high quality is always a determinant factor, that creates an advantage to convert industrial structure into industries with high-tech concentration, to ensure raising competitiveness during integration process. This is also a condition to catch up other preceding countries. Beside outstanding aspects in potential of Viet Nam human resource, a high unity on culture, particularly language, enable popularizing education to be made easily and knowledge transfer in a rapid manner, it is possible to say that, Viet Nam human resource is both a factor of "static competition" in advantage of developing manpower industries at the moment as well as a factor of "dynamic competition" in considering and selecting spear-headed industries with high technology in further step. However, currently, Viet Nam human resource has many limitations in terms of qualification, workmanship, they have no industrial habits, their managerial staff is lack of knowledge and experiences on market, business particularly lack of excellent businessmen staff. It requires to identify weak points so as to have solutions to develop human resource for the strategy of industrial development. Training must be associated with industrial development requirements.

The above mentioned resources, in circumstances of the world's economy whose rapid changes are taking place towards the trend of globalization and integration, will be good premises to grasp opportunities for industrial development, market expansion and raising effectiveness of industrial development. However, these advantages could become competitive advantages only with a good policy.

2. Viewpoint on developing Viet Nam industry in socio-economic development strategy in upcoming years.

(1) Concept on industrialization, modernization and tasks posed for industrial development.

Industrialization is a process of changing socio-economic structure with a view to developing strongly industry along with technological renovation, creating an outstanding development of industry as a springboard for rapid, highly efficient and sustainable development of the economy and society as a whole. Industrialization is a development stage of necessity for nations striving for becoming an industrial nation from a basically agricultural economy.

In international circumstances with many rapid changes in terms of economy as well as science and technology, a lot of challenges are facing with Viet Nam: Whether to reduce gap, or to be left behind farther and farther as compared to developed countries even nations in the region. Therefore, industrialization and modernization constitute an urgent demand so as to bring Viet Nam up to a stage of new development. Our striving target is to become an industrial nation after 20-25 years to come.

For reducing gap between us and developed countries, industrialization must be associated with modernization. Industry must access to state-of-the-art technologies. So, and so only, can it raise industrial competitiveness and realize integration in an efficient manner into regional and international markets.

However, a practical problem posed for the cause of industrialization and modernization of Viet Nam is the pace and options during industrialization.

(2) *Problems posed for Viet Nam industry development in the strategy of socio-economic development in the new stage.*

Industrialization, modernization have determined position of industrial development in the strategy of socio-economic development of our country.

In the new stage, development of the industry must meet requirements as follows:

- Industry as a protection industry generating large added value should provide a major contribution in economic growth in general.
- As an industry manufacturing capital goods and equipment for other sectors, the industry shall create motive force to urge on development of other sectors.
- Creating conditions to raise value of Vietnamese goods in the market (both inside and outside the country).
- Rapid and sustainable development and it is an important factor in expanding trade relationships.
- Creating conditions to settle social problems

(3) *Different viewpoint on Viet Nam industry development*

Currently there are different viewpoints on Viet Nam industry development which can be summarized into some kinds as follows:

(a) An industry enough strong with a complete industrial structure must be paid attention and earlier developed, in the nearest future, to be developed in the orientation to substitute imports, meeting enough domestic demands, raising self-reliance/ independence of the country in circumstance of globalization and integration into world's economy.

This viewpoint poses problem to develop industry oriented to using most domestic natural resources, with huge investment focusing on industries producing key materials at the same time meeting requirements for industrial consumer goods needed for local market. Practice shows that this viewpoint for industrial development is too ambitious while local resources are limited and external resources are difficult to be involved by such an inattractive policy of industry. Globalization and integration for Viet Nam to be able to participate much more in the process of international labor division and cooperation. Industrial development requires appropriate options to secure the use and making the most of local resources, bringing about huge effects to national development.

(b) Development strongly oriented to export, exploiting comparative advantages of the nation to create a lot of added values, increase accumulation as a basis for investment and development of economy in general, gradually coming up to develop a complete industry in further stages.

Export-oriented development policy will create obviously rapid development of industry as well as efficiency thereof and all the economy in conditions of local market that is still small (in buying capacity). Currently, there have been many examples to prove this.

However, a development policy for an industry strongly oriented to export often tends to put industrial development into manufacturing industries that use a few natural resources, with big size, requiring huge investment and technologies complicate both in scale and qualification.

Recently, there have been some viewpoints that in circumstances of international integration, an export-oriented industry strategy wins no longer important positions. This issue has caused many disputes. In practice, it is show that, such a strategy does maintain its value.

Developing export-oriented industry has been creating favorable conditions to promote Viet Nam economy integrated into world's market, to make the most of opportunities bringing this process and comparative advantages of Viet Nam.

(c) *To access and catch up world's economy and industry, there are opinions that, it requires to develop high-tech and modern industries as soon as possible. However, there are another opinion that in the nearest future, it requires to develop labor-intensive industries in order to resolve big social problems such as employment and income for the community.*

In conditions that Viet Nam's economic potential is still weak, with its restricted social investment, the development of high-tech industries requiring huge investment is a difficult problem, particularly if using old approaches "the State invests directly into development of these industries", this problem becomes more difficult due to scare resources.

However, development of high-tech industries is very necessary, if we don't want to be left behind.

The answer belongs to macro-policies to create conditions for involving social investment in developing these industries.

In practice, it is shown that the State is very difficult to invest into development of all industries and fields of industrial activities. Hence, a development strategy for industry intensively oriented to export, substituting selectively imports, making the most of comparative advantages of the country in industrial development, taking opportunity to develop high-tech industries combined with labor-intensive industries to resolve social problems will be orientations for macro-policy solutions, creating environment for investors and all people to participate in industrial development. Success or development of industry oriented to shaping an enough strong industry with competitiveness in world's markets is quite subject to these macro-policies.

With a view to coping with requirements for industrial development in the new stage, viewpoints on development (as of referential nature) of the industry sector are as follows:

- Developing industry with a high speed, in an sustainable and efficient manner. Relying on making the most of comparative advantage, raising competitiveness per each product, making best use of internal strength and international cooperation, as a motive force to promote industrialization and modernization.

- Actively participating in integration into regional and global markets. Combining the development of export-oriented industries and substituting imports in an efficient manner participate in industrial development under market mechanism and with the State management and regulation. Giving strong incentives to develop small and medium businesses, creating the task assignment and cooperation in industrial production.
- Impact strongly on agriculture and countryside industrialization and modernization with appropriate site and technologies.
- Choosing top-priority industries in line with comparative advantages. Creating a dynamic and efficient structure of industry and ensuring sustainable development. Immediately going straight to modern technologies, reducing the gap between our country and other countries in the region.
- Developing industry associated with urban planning and environmental protection. Preventing an excessive concentration of industry on big cities, creating a network of small and medium urban areas, harmoniously across the country.

3. Objective of Viet Nam industry development

(1) Objective of growth:

Forecast of many experts and research institutions indicate that growth-rate in increase value of industry (including construction) averaging in 10 up coming years may reach 10-10.5% per annum.

By 2010, industry and construction with represent 40-41% in GDP and involve about 23-24% employees. Export turnover of industrial products accounts for 70-75% of total export turnover of the whole country.

These growth objectives, in our opinion, is feasible, even with a faster pace. However, the true answer for the slow or fast growth-rate, once again, is subject to solutions in terms of economic mechanism and economic policy in general and industrial policy in particular, oriented to forming a reasonable industry structure.

Some other forecast put forth target of output of some commercial product industries as specified: Producing 69-71 KWh electricity: 34-35 million tons of crude oil; 12 million tons of petrol; 17-19 million tons of coal; 2.4 - 2.5 million tons of phosphate fertilizer; 2-2.2 million tons of cement; 0.9 - 1 billion meters of fabric; meeting 50% of medical drugs requirements; mechanical engineering meeting 40% of domestic demand and rate of domestication up to 60 - 70%. These development indexes, in our opinion, is of referential value.

(2) *Conversion of Viet Nam industry structure*

Studies on an appropriate industry structure for Viet Nam as basis for adjustment of Government's policies oriented to shaping a sustainable industry structure, ensuring rapid growth of the industry, promoting the development of the economy and society as a whole.

In our opinion, a reasonable structure of industry should ensure:

- Association of the high speed of industrial growth, increasing proportion contributed by the industry into general development of the economy.
- As a result of reasonable resource allocation to development of the economy in general and the industry in particular. Such an industry structure is established on a basis of : (1) Direct allocation of resource available from the State - budget (2) mobilizing social resources through indirect policy solutions creating environment for involving people to participate in investment to industrial development. So
    - Associated with the trend towards forming an enough strong industry, intensifying internal strength in industrial development, make the most of comparable advantages of the country. To do this, industry policy should enable industry sector to exploit comparable advantages of the country for strong development.
    - Associated with the creation of an organization form of modern and efficient industry in an industrial link as per territorial areas, make the most of advantages of every territorial area and taking part in industrial production and cooperation in the region and in the world.

With such criteria, in our opinion, policy of industrial structure conversion in the next stage requires to be oriented as follows:

- Continuing development of industries that use comparable advantages of our country such as human resource, natural resources to convert gradually these industries into processing-intensive industries with high quality to raise value of industrial products of Viet Nam in domestic and international markets.
- Converting gradually from downstream industries with high added value, requiring small fund into upstream industries in a sustainable industry link so as to further exploit domestic industrial potential and raise industrial efficiency.
- Converting structure of using technologies oriented to high-tech industry, associating industry development with technologies.
- Converting structure of organizing industry in the orientation "self-contained" in existing enterprise into production assignment and cooperation much more between sizes/ scales, specialization as per technological processes associated with cooperation, forming auxiliary industries, enabling enterprises to raise domestication rate in industrial development.
- 5. In fact, it is difficult to identify a route of restructuring in a rigid manner, stages of

restructuring/ structure conversion may take place gradually from the overall aspect of the industry sector as a whole, however the arrangement of stages in a given aspect, an area of industrial activities is very necessary with a view to creating industries, activities pushing up the general development of the sector as a whole.

Policy of restructure/ structure conversion shall take this point into consideration.

(3) Solutions for rapid development of industry with appropriate structure conversion

Solution for the question: is it feasible or not a rapid development of the industry sector in the next stage as a premise for general development of the country under proper policy of industry. In our opinion, rapid and sustainable development of industry is quite feasible.

In conditions that resources for Viet Nam industry development are still restricted (as analyzed above), the choice of targets, resource allocation and involvement, additional exploitation of external resource are of prime importance and should be deliberated.

For achieving objectives of industrial development as mentioned above, it is recommended that the Government should continue to implement the following contents in the nearest time:

- Formulating as soon as possible a policy of industrial development in the next stage (including strategy and framework as well as specified policy solutions in the years to come)
- Study and developing strategic orientation as well as policy for using state-budget in an efficient manner under two forms: (i) direct investment to developing a number of particularly important industries and projects, provided ensuring economic efficiency (ii) investment into infrastructure service sector (including technical and social infrastructure) creating indirect conditions for industry development. Of which indirect investment to infrastructure service sector is especially important.
- Developing long-term policy framework as well as macro-economic management policy-solutions creating conditions for enterprises (both state-owned and private, including overseas private enterprises) to carry on business and invest to industrial development. Confirming the role of private sector and formulation of policies in terms of finance, land, industrial properties, standardization, market management and so on. Change of policy for management of industrial development is a crucial condition for a rapid, strong and sustainable industry development with the participation of many forces.
- Continuing the good implementation of reform and renovation of enterprises and businesses.
- Perfecting law system associated with strengthening capacity of State-control administrative system and law enforcement, raising legal values of Government's policies to establish confidence and trust of the public in general and business-owners in particular in investment to industrial development.

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Free Trade versus Infant Industry Promotion

The Possibility of Temporary Protection for Latecomer Countries

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1. Introduction

For Latecomer developing countries like Viet Nam, international economic integration is both an opportunity and a challenge. On the one hand, strong foreign influence acts as great pressure and incentive to change, and if this influence is properly guided and utilized, the country can enter a new age of dynamism and prosperity. On the other hand, facing this powerful force without adequate preparations is risky and may lead to macroeconomic instability, social strain and national identity crisis. In either case, this is a critical historical moment for these countries, and policy makers bear a very heavy responsibility. Integration must surely be pursued, but its manner and timing must be carefully designed in order to maximize its benefits and minimize its costs. Integration should be neither too slow nor too fast. It should be paced so as to stimulate realistic domestic reforms with the right amount of external pressure, not more, not less.

This paper discusses both theoretical and practical issues concerning the commitment to free trade by latecomer countries trying to catch up with early comers. It also offers some policy suggestions regarding how Viet Nam should implement AFTA obligations and proceed with WTO accession negotiations.

The dominant trade theory which supports free trade can be challenged for the lack of dynamic and historical considerations. However, the feasibility of temporary import protection for latecomers is severely constrained today by accelerated international integration on the one hand and limited domestic capability on the other. In order to justify industrial promotion through temporary import protection, latecomer countries should improve the capability of both government and domestic enterprises. Our proposal is that this capability should be nurtured—and externally demonstrated—primarily through presenting concrete and reasonable promotion strategies for a relatively small number of selected industries. At the same time, international economic rules surrounding IMF, World Bank, WTO, AFTA, etc. need to be modified so as to enable latecomer countries to execute reasonable industrial development policies (although this policy revision is beyond the power of the Vietnamese government). For Viet Nam, both of these conditions remain yet to be satisfied.

2. The theory-history nexus

Comparative advantage doctrine

Ever since the mid 19th century, the dominant academic paradigm in trade theory has been that of comparative advantage. Comparative advantage is said to be one of the most difficult concept for laymen to understand. Briefly, it says that if each country exports goods it is relatively good at producing and imports goods it is relatively poor at producing, all countries will gain regardless of income level or economic structure. As long as countries are different in technology (Ricardian model) or in factor endowments (Heckscher-Ohlin model), potential gains from trade always exist.

More concretely, comparative advantage can be explained by way of an example. Consider a professor and a research assistant with two tasks—writing an academic paper and making photocopies. The professor is better at both tasks than his assistant. Does this mean he should do both works and the assistant should remain aside, watching? Of course not. Efficient division of labor depends on relative skillfulness between two tasks for each person ("comparative advantage"), rather than relative skillfulness between two persons for each task ("absolute advantage"). If the professor is five times more efficient in paper writing than the assistant and two times in photocopying, comparatively speaking, the professor is more skillful in paper writing and the assistant in photocopying. The two should divide the tasks between them ("specialize") accordingly. If the story is reinterpreted as two countries engaged in the production of two goods, we have a theory of comparative advantage.

The comparative advantage theory was first clearly proposed by the British economist David Ricardo in the early 19th century in his attack against mercantilism, which favored official intervention in international trade. The policy implication of Ricardo's doctrine was immense and long lasting; it refuted the validity of trade protection and argued that free trade, not government intervention, was the correct public policy. Ever since, this theory has always remained at the "core" of economic teaching and trade policy debates. As an academic doctrine, the comparative advantage theory is one of static general equilibrium which is simple, elegant and symmetric. As such, it is easily expandable mathematically.[1]

[1] Around the theoretical "core" of comparative advantage, there are various sub-theories in the "protective belt," accumulated through past academic and policy debates and supporting or supplementing the core (see Irwin [1996] for more detail). Those Sub-theories have covered the following areas: (i) balance of payments impact; (ii) relationship between productivity and wage; (iii) modification when the home country is large ("optimal tariff theory"); (iv) whether tariffs are justified when there is domestic economic distortion (the answer is no); (v) redistribution effects of trade; (vi) the case where prices are sticky and frictional unemployment emerges; and (vii) the case where factors of production are mobile internationally. These model variations are theoretically important but not very relevant or helpful in solving the actual problems that Viet Nam faces.

However, from the perspective of latecomer countries, the main weakness of the dominant doctrine is its indifference to historical or structural context. The Ricardian model is so static and simple that it cannot deal with interesting dynamic questions, such as the way to overcome the technology gap, how to deal with strong competition from developed countries, or which industries should be selected for promotion under temporary protection. In fact, the dominant theory does not even provide any logical framework for discussing these crucial questions in a concrete and realistic way.

Trade theory in historical perspective

Economic theories evolve through internal academic innovation as well as external historical influences. The conclusion of the comparative advantage theory, that free trade is beneficial for all countries, is often presented as a universal truth and a (near) consensus in economic profession. However, historical circumstances in which this theory appeared in the United Kingdom in the 19th century were very unique. Despite the appearance of a general theory, the doctrine of comparative advantage is highly history-specific. Its conclusion also depends on various assumptions that can be challenged on theoretical and empirical grounds.

The emergence and popularity of free trade theory is greatly affected by the particular position of a country or an industry in the existing power relations of the global economy. Generally speaking, a country which has already achieved a dominant economic position tends to prefer free trade, imposing it on others who are "less enlightened." By prohibiting temporary import barriers, free trade serves the interest of the early comer by ensuring global markets for its products and frustrating latecomers' effort to catch up. On the other hand, latecomer countries wishing to industrialize against the competitive pressure from early comers promote alternative models which justify intervention and protection under certain conditions. Similarly, within a country, industries enjoying strong export performance lobby for free trade, while newly emerging industries threatened by imports demand protection.[2] Whether protected industries really grow under protection is a separate and important issue which will be discussed below.

Today's industrialized countries also had periods of industrial promotion under import protection in the past. Some examples are given.

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[2] The textbook analysis of consumer and producer surpluses contends that, while protection may benefit certain producers, the country as a whole will lose if consumers' utility and government revenue are properly taken into account. While this argument may be used politically to resist unreasonable demands by interest groups, it shares the common analytical weakness of the dominant paradigm; it is static and devoid of any historical or structural context. Moreover, empirically, the static efficiency effect is usually very small and can be easily dominated by other dynamic effects, whether positive or negative.

United Kingdom: Until the middle of the 19th century, the British market was protected from foreign agricultural commodities and especially cheap Indian cotton products. Mercantilism, a doctrine that seeks to generate trade surplus by restricting imports and promoting exports, was theoretically defeated by Ricardo's model of comparative costs. It is true that Ricardo was a great economist, but his model also served important political purposes. The emergence of the Ricardian theory coincided with Britain's historical turn from protection (e.g., Corn Law) to free trade, and Ricardo in effect defended the interest of the new merchant class (of which he was a member) who wanted free trade against the interest of the landed class. As the UK's global dominance in manufacturing was firmly established by the mid 19th century, the country began to preach free trade to the rest of the world. Free trade helps to secure the superiority of the first comer by not allowing latecomers to promote modern industries that would compete with the British. The historians' term "imperialism of free trade" describes the British policy during this period of pursuing "informal rule [free trade] if possible, but formal rule [colonization] if necessary." Thus, free trade and military conquest were two alternative means to pursue the same British overseas interest.

United States: From even before political independence and throughout the 19th century, America was sharply and geographically divided between free trade advocates in the south and protectionists in the north. Northern industrial states demanded protection against British products while southern plantation states with competitive cotton exports wanted free trade, ensuring cheap imports and free access to the British market. Alexander Hamilton represented the northern voice, advocating industrialization under protection and a centralized federal government, while Thomas Jefferson preached free commerce in the interest of southern planters. The US eventually grew to be a free trader, but only after a civil war and the completion of successful industrialization in the late 19th century. The American tariff rates were very high during the most of the 19th century.

Germany: Industrial revolution of Germany began much later in the late 19th century, under the heavy hand of the state. German customs union was created and public investment in railroads and heavy industries was vigorously implemented. Latecomers' protection was justified by the infant industry protection argument of Friedrich List who contended that proper trade theory depended on the particular development stage of a country. According to List, creation of manufacturing base and upgrading the commodity composition of trade were more important national goals than pursuing pure commercial profits.

Japan: After opening up to the world economy in the mid 19th century, Japan found itself desperately lagging in industry and technology. For the first half century following that, Japan had no tariff rights and had to industrialize under the uniform tariff of 5 percent. However, this did not seem to hurt the economy greatly since Japan was a primary commodity exporter (mainly silk, followed by tea, seafood, grain, copper, coal, etc.) and there was virtually no domestic manufacturing industry worth protecting.[3] However, by the early 20th century Japan had succeeded in light industrialization (textile) and was ready to develop heavy industries. This coincided with regaining of full tariff rights in 1911. Japanese tariffs were raised selectively to protect machinery, chemical, and other new industries. High protection was finally removed after WW2, during the 1960s and 70s when Japan had already achieved a status of an advanced economy with high technology.

Australia: In the late 1920s there was an argument for protection in Australia, advocated mainly by J. B. Brigden. He argued that primary commodities, in which Australia had comparative advantage, exhibited decreasing returns. Specializing in them would result in higher costs at home and depressed prices abroad, thus reducing the real income of the Australian people. Moreover, free trade would have adverse distributional effects as a handful of landlords benefited at the cost of the working majority. However, as it turned out, Australia did not subsequently succeed in industrialization and has remained a sparsely populated primary commodity producer to this date, despite its relatively high income.

Alternative views: lack of guideline

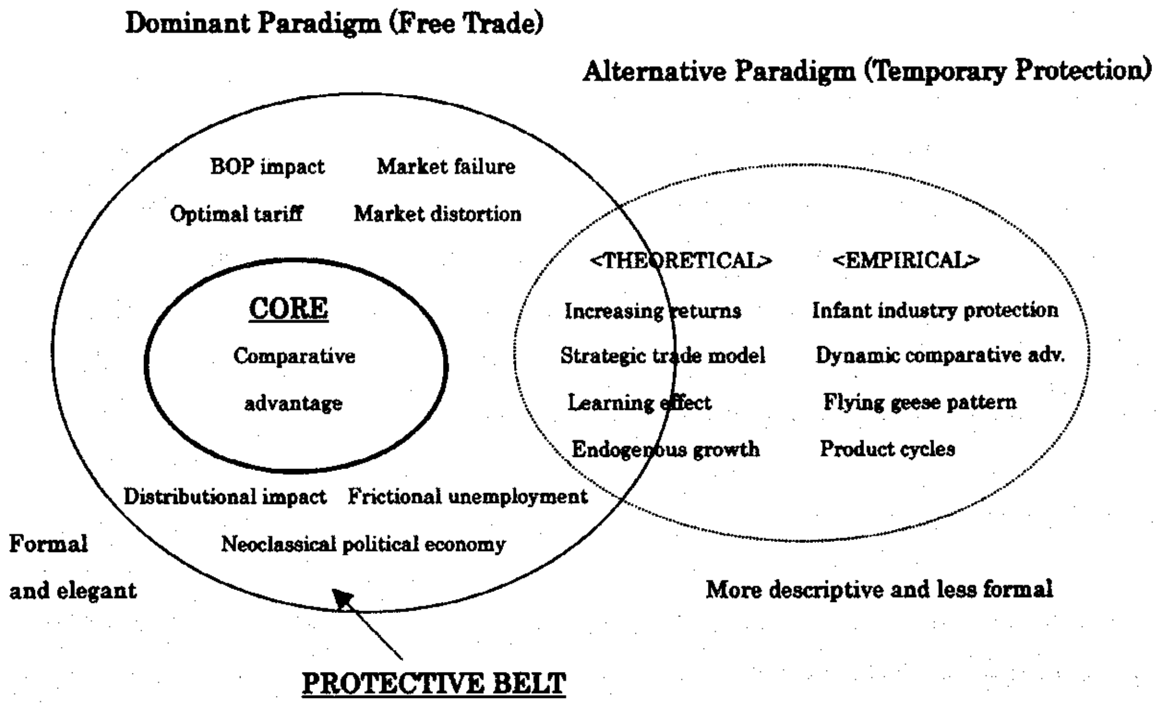
One of the problems for latecomer countries, who must face a very competitive world even before establishing any modern industries, is the absence of a useful system of intellectual arguments to guide their policy of temporary import protection. Even though the "imperialism of free trade" seems unfair and unreasonable to them, there are few convincing theories to effectively counter it.

Compared with the dominant paradigm of comparative advantage in support for free trade, the alternative paradigm in support of temporary import protection is less clearly defined. Empirically, the alternative paradigm asserts that effective protection of certain industries is necessary (but not sufficient) in the catching up process ("infant industry protection argument" of Hamilton and List above). It also presents a set of theoretical models justifying intervention based on the notion of increasing returns, broadly defined.[4] However, the alternative paradigm is without the mathematical elegance and integrity of the comparative advantage theory. Many of the models in the alternative paradigm are often descriptive rather than theoretical, and look more ad hoc. The

[3] Sir Rutherford Alcock (1809-97), first British ambassador to Japan, demanded the removal of Japan's political and social impediments to trade (i.e., NTBs) and argued the merits of unlimited trade as an automatic equilibrating mechanism. In his book [Alcock 1863], he also wrote that, if persuasion did not work with the Japanese government, military power might become necessary to improve the situation. By contrast, the Japanese leader and prime minister Hirofumi Ito (1841-1909) criticized the principle of free trade, saying that it would only serve British interest. According to Ito, free trade would greatly harm Japan which was only "half-developed" at that time.

[4] Increasing returns models can be interpreted as belonging to and an extension of the protective belt of the dominant paradigm. However, its policy implications are often quite the opposite of the dominant paradigm which justifies free trade rather than protection.

dominant paradigm considers the alternative paradigm outdated and already proven to be irrelevant or even harmful. Although the alternative paradigm gathers many avid followers, it has less academic appeal due to its absence of formal structure and institutional apparatus. The current theoretical landscape is presented schematically below.



Although not very popular among the practitioners of the dominant paradigm, theories that recognize the importance of history and the specific position of each country do exist. They are usually called the "stage of development" models. For example, Kuznets [1971] introduced the notion of "Modern Economic Growth" in which the impact of the British Industrial Revolution was transmitted to the rest of the world through technical innovation and social change. Similarly, Gerschenkron [1962] analyzed the advantage and disadvantage of backwardness in the context of Western European industrialization, again with the United Kingdom as the leader.

Furthermore, some Japanese economists have presented models that can explain the patterns of industrialization in non-Western countries. The flying geese pattern model, proposed by Akamatsu and further developed by Kojima [2000], is particularly famous. Watanabe [1995] also presents his "structural transformation chain" model of Asian economies. These models point to the historically common pattern of successful industrialization in which some products are first imported, then domestically produced and finally exported. Establishment of these industries takes place sequentially, from food processing to textiles and garment, steel, chemicals, then to machinery, electronics, and information technology. Countries with different stages of development specialize in different products, and active trade and FDI among them raise the overall level of regional industrialization. This dynamic process is now well known, especially in East Asia, and these Japanese economists contributed to this common understanding.

However, although the models of Kuznets, Gerschenkron, Akamatsu, Kojima and Watanabe can successfully describe "stylized facts" in the past, they are not very useful as an operational future guideline for countries faced with practical questions of integration. Concrete strategies cannot be readily derived from these generally descriptive theories (this by no means lessens the intellectual value of these models, however).

More recent methods include computer-aided econometric data analyses, such as calculation of effective tariff rates, revealed comparative advantage (RCA) analysis, and computable general equilibrium (CGE) models, conducted by university economists and international organizations. While these look awesome and highly complicated to laymen, they also share the same vital defect with the dominant paradigm, namely, they are all static. Studying the recent past in detail does not permit the researcher to predict the future correctly, especially of a country going through the dynamic process of marketization and international integration. Evolution of a new system and social response to it cannot be predicted by extrapolating the past using fixed coefficients.

What seems to be keenly desired in a country like Viet Nam is neither abstract theory nor computerized data analysis. Nor is the general assertion of efficiency of idealized free trade very useful. The Vietnamese government would like to have an operational guideline which can analyze the actual problems on the way to integration and suggest concrete policies to deal with them, step by step. However, such a convenient theory may not exist, if only because such wisdom exists in the accumulation of actual practice. The secret of industrial promotion cannot be learned passively from outside using an operation manual.

3. Increasing pressure to integrate

Globalization since the 1990s

As the Soviet Union collapsed and the US economy prospered thanks to the IT Revolution and booming asset markets, the US-led global economy emerged in the 1990s. In such a unipolar world, pressure to integrate with the global economy naturally intensified for developing and transition countries. For Viet Nam which began to integrate only in the 1990s, the integration shock is even greater. Integration is required in a large number of areas including law, labor practice, accounting, enterprise management, trade, finance, governance, environmental protection, etc. and even in building a civil society and democratic institutions. Integration may occur spontaneously or under duress: sometimes through voluntary action of the country and other times through regional peer pressure or external loan conditionality. International organizations are ready to help—or press—latecomers to open up and accept international codes of conduct.

As time passes, the challenge of integration for remaining developing countries has become even greater [Ishikawa 2000]. First, the relative gap in the level of achievement of the market economy between advanced and developing economies has widened during the last several decades. Second, after some successful countries (such as NIEs) exit to the industrialized world, the average institutional capability of the remaining countries is very low ("losers' bias"). Third, pressure to integrate has intensified without simultaneous improvement in domestic capability. In the post cold war period, latecomer countries with very weak competitiveness, policies and institutions are often unable to properly manage the integration process and encounter serious difficulties. Many of them hasten to integrate without sufficient preparations, often inviting social crises or the loss of macroeconomic control.

Dynamic disciplinary effects of free trade

The challenge of integration cannot be avoided and, in fact, it should be welcomed. In the long run, opening up to foreign competition is a prerequisite for sustained economic development and systemic transition. Without that move, domestic industries will stagnate and fall hopelessly behind in technology and productivity. Free trade invigorates the national economy through the following channels (provided that at least some domestic enterprises can meet the challenge):

- Improving static efficiency of resource allocation (Harberger triangle effect—but this may not be very large empirically)
- Forced exit of inefficient producers
- Disciplinary effect on surviving industries for constant improvement
- Importing more effective rules and systems from abroad
- Defeating domestic monopoly (whether natural or policy-created)
- Protect the government against political capture by interest groups
- Avoiding retaliatory trade measures by other countries (reciprocity)

Risks of premature free trade commitments

However, commitment to trade liberalization also carries risks for latecomers. Quick integration with very unstable and competitive global markets, without proper preparations in industrial competitiveness, policy capability and institutional building would lead to the following:

- Sudden loss of output and employment beyond socially tolerable limits

- De-industrialization and primary commodity lock-in
- Increased price and demand shocks from abroad
- Emergence of new income gaps between rich and poor and across regions
- Foreign economic dominance
- Environment destruction and resource exploitation beyond recovery
- Social and political instability
- Loss of cultural and national identities

Brutal markets and the lock-in effect

Some of these risks may be further elaborated.

Forceful penetration of the global market system into domestic society not only can unleash positive dynamism but also may bring serious social tension. Economic anthropologist Karl Polanyi has been most eloquent on this inherent dilemma [Polanyi 1957]. He argued that economic systems prior to the 19th century were all "embedded" in society. That is to say, economic activities such as production, exchange and consumption were all subordinated to the unique structure of each society. However, after the British Industrial Revolution, the market system based on machinery and factory production began to invade society. The market system is so powerful and "self-regulating" that it transforms society according to its requirements rather than being shaped by it. If the market system demands a large number of wage earners, contract-based transactions, modern firms and a stock exchange, society is obliged to supply them. For Polanyi, it was particularly worrisome that primary factors of production—labor, land and money—which were not originally intended to be bought and sold were now transformed into pseudo-commodities. Uninhibited, the logic of the market economy—which he called "Satanic Mill"—would destroy human character, social relationship and natural environment. The brutality of unrestrained markets is so severe that it spontaneously triggers the emergence of defense mechanisms by workers, businesses, charity groups and the government.

Another aspect of the unrestrained global market system is to widen the gap between early comer and latecomer countries. In a world of increasing returns (i.e., a large set-up cost followed by a subsequent rise in productivity), free trade tends to solidify the position of initial achievers and condemn latecomers to economic underdevelopment. If a latecomer country joins the global market prematurely, its economic structure may even regress backwards (de-industrialization is actually observed in CIS and Mongolia). As the existing weak industrial base collapses under severe foreign competition, its economy is locked into the status of a primary commodity producer, in which its current comparative advantage lies. As IT and advanced manufacturing are monopolized by early comers, it is difficult for latecomers to enter these fields, let alone excel in them.

Some latecomers resist this natural tendency of "winner-takes-all" and try to catch up. The driving force for this deviation does not come from laissez-faire but from combined efforts of government and businesses under a strong sense of nationalism. Temporary import protection has been a key ingredient in the catching up strategy, but under globalization its use is highly restricted. Some argue that, even under free trade, today's developing countries can have certain new industries with FDI promotion and non-trade measures not prohibited by WTO. However, permissible industries are often concentrated in light and low-tech industries (such as food processing, textile and garment, footwear, tourism, etc.). Heavy industries and advanced manufacturing which require large initial investment under increasing returns (such as steel, chemicals, fertilizer, machinery, automobile, etc.) are likely to be ruled out. Whether that is an acceptable development path is an open question. Another unresolved issue is whether leapfrogging into high technology (such as information, telecommunications, finance) is possible or even desirable from the viewpoint of the national economy.

4. Lack of domestic capability

Desirability of catching up is one thing. Feasibility of such a strategy is quite another problem. Industrialization under integration pressure requires strong capability of both government and business enterprises. Without it, the country would repeat the many misapplications and outright failures of protection policies of other countries in the past. Risks involved in temporary import protection are proportionally greater if the country lacks such capability. At present, whether the Vietnamese government and business community possess such capability is seriously in doubt. These domestic weaknesses are the most serious barrier against integration. Since this point is well recognized in Viet Nam, this section can be brief.

<u>Underdevelopment of market and limited private response</u>

A vigorous market economy does not spontaneously emerge in any society. On the contrary, societies that achieve it are relatively rare. And even for those countries which are now fully industrialized, development of the market economy has been a long evolutionary process with many pitfalls; it was not created by short-term social engineering. The growth of the market economy requires certain historical preconditions regarding productivity, distribution system, social organization, etc. Today's remaining low-income countries are generally not well equipped with these conditions. In fact, it can be even said that the lack of these conditions is the main reason why they remain unindustrialized. Underdeveloped private businesses may fail to respond positively to policies intended to help them, such as deregulation, privatization, trade liberalization, SME promotion, creation of a stock exchange, or establishment of an internationally accepted legal framework.

Weak government and political capture

Another serious problem is the inability of government to properly design and implement industrial promotion under temporary import protection. In the standard economics textbook, the roles of government include correcting market failure, supplying public goods, macroeconomic management and income redistribution. In a latecomer country, government has additional and even more important roles: it has to implant a new market economy in society as well as manage the external integration process. However, as is well known, governments in these countries are often characterized by low capacity, rigidity, red tape, corruption, low salary, political influence, etc. Not only the economy is underdeveloped but government which is supposed to guide it is also underdeveloped.

When the government is incapable of distinguishing infant industries from inefficient senile industries, policy intervention only distorts resource allocation without accelerating growth. If the government is additionally susceptible to political pressure, protection policy can easily be hijacked by interest groups, leading to permanent protection of hopeless industries. Analyses of "neoclassical political economy" by economists in support of free trade such as Anne Krueger (rent-seeking); Jagdish Bhagwati (directly unprofitable profit-seeking, or DUPS) and Ronald Findlay (interest lobbying) highlight these political risks.[5]

World Bank and institution-building

The World Bank's view on the institutional capability of developing countries evolved substantially during the 1990s. Previously, under the strong influence of neoclassical development economics, the World Bank promoted openness and small government in all member countries and counseled against selective industrial policy. However, in its 1993 "East Asian Miracle" report, the Bank noted that some economies with strong institutions (Japan, Korea, Taiwan, etc.) successfully conducted financial and trade interventions. In the 1997 World Development Report, the Bank further rejected the idea of minimalist state and agreed that the state's role in development was very important. A two-part strategy was proposed in which (i) the state's role must be in proportion to its present capability; and (ii) capability should be improved over time. Theoretically then, for countries achieving high capability, even selective industrial policy is permissible. Today, however, the World Bank policy under CDF and PRSP seems to have degenerated into imposing uniform and abstract programs for institutional improvement, such as partnership, good governance, accountability, transparency,

[5] One historical example of managing integration while strengthening domestic capability is provided by Japan's accession to GATT and OECD during the 1960s. Using international commitments to guard against inefficient protectionism, MITI urged domestic producers to improve competitiveness before trade barriers were lifted, rather than lobby for more protection. At the same time, the government provided result-oriented incentives to enterprises which successfully raised productivity.

civil society, etc, regardless of the initial conditions of a particular country. Whether such an undifferentiated approach is useful at all remains to be seen.

5. Current issues for Viet Nam

In the remainder of the paper, Viet Nam's integration policy questions are discussed more in detail.

Need for policy consistency

When a developing country faces strong pressure to integrate, there can be a variety of policy responses. For example:

Pattern 1—Successful integration: under national consensus, both government and businesses, though encountering many problems, endeavor to improve productivity, policies and institutions to achieve industrialization under integration (Meiji Japan, NIEs).

Pattern 2—Gradual integration with ownership: regardless of external pressure, the country proceeds gradually and experimentally to introduce markets and open up its economy at its chosen speed, thus avoiding both radicalism and back-tracking (China-but only large countries with political clout can choose this path).

Pattern 3—Big bang integration: although domestic capability is still weak, bold integration and marketization measures are adopted as a matter of principle, causing serious harm to people's living and domestic industries (Mongolia, Kyrgyzstan).

Pattern 4—Reversal: realizing the danger of integration, the country regresses back to control and regulation (temporarily?) to protect itself, antagonizing IMF (Uzbekistan, Turkmenistan; emergency measures against currency crisis adopted by Malaysia and Kazakhstan can be interpreted as a mild form of this).

Pattern 5—Inconsistency and delay: While the country clearly understands the need for integration in general, it is unable to make concrete preparations due to the lack of political will or policy capability. As a result, mutually inconsistent policies are implemented, such as committing to AFTA while introducing trade barriers (Viet Nam). If left uncorrected, the country may fall into either Pattern 3 or 4.

Each country going through integration is unique. Some countries continue to argue the general merits and demerits of market versus government, or the superiority of big bang transition versus gradualism. But Viet Nam is relatively free from such abstract debates and knows well that market and government must be combined properly and that extreme policies should be avoided. However, the main problem with Viet Nam is the lack of concrete action. During the past five years of the Japan-Viet Nam Research Project, initially identified problems—such as the need to temporarily promote selected industries—remain basically the same, but no effective effort to identify candidate industries has been made (see below). In 1998-99, the Project urged the Vietnamese authorities to officially declare a firm long-term commitment to integration and marketization while utilizing the limited time and methods to promote a small number of carefully selected industries with temporary protection. However, no action has been taken so far. In the mean time, the AFTA deadline is approaching quickly.

Viet Nam's inability to act promptly comes from various sources. For example, consensus-based decision making, decentralized responsibility among various ministries and organizations, political tug-of-war between central and local governments, pressure from affected industries, shortage of experienced officials and a general lack of time and knowledge, all contribute to slow action. While policy rigidity provides stability in normal times, it would lead to economic stagnation when the country must respond quickly to changing circumstances. Although the governing system cannot be altered immediately, there should be a constant effort to concentrate and speed up the decision-making process even under the existing system. At present, the Vietnamese government and industries are ill-prepared to face the challenge of integration. If consistent policies cannot be designed, temporary import protection for selected industries should not be implemented. This is so not only because such policy would invite international criticism but also because of the expected enormous cost to the national economy.

<u>Selecting industries</u>

For temporary import protection, the first crucial step is to select a small number of candidate industries for promotion. This point has been clearly recognized in Viet Nam, but no effective procedure for industry selection has so far been discovered. Existing economic theories are too abstract to be useful for such a practical problem. Therefore, Viet Nam must devise its own method to identify prospective industries (although other latecomer countries also face the same problem).

One possible methodology is to list the general criteria by which to choose candidate industries. For example,

- Labor intensity and employment impact
- Forward and backward industrial linkage

- -- Possibility of rapid productivity growth and technology absorption
- -- High income and price elasticities of demand (domestic and overseas)
- -- International market conditions and competitors' behavior
- -- Balance of payments impact
- -- Social impact and regional equality within the country
- -- Possibility of use of domestically available raw materials

Problems with this approach are two-fold. First, information requirement is enormous. Unless each industry is studied very intensively, these criteria cannot be actually used to select candidate industries, but no organization—domestic or foreign—has conducted in-depth research on so many aspects of so many industries. Second, even if necessary information is gathered, how to consolidate these multiple criteria into one and rank industries is unknown. At present, this approach remains too general to be operational.

Another approach is to infer the competitiveness of each industry from a relatively simple indicator, such as the price gap between domestic and foreign products or the current level of import protection. One such approach has been taken by the Vietnamese government itself. It is reported that the government has been conducting an internal study to assess the competitiveness of some (but not all) industries on an experimental basis and without direct policy implications. According to the press report, industries are classified in three groups:

-- <u>Group 1: Competitive</u>—coffee, cashew, rice, pepper, aqua-products, garment, footwear, small diesel engine, tourism, construction service;

-- <u>Group 2: Competitive if proper support is provided</u>—tea, rubber, vegetable, wood product, industrial salt, some tropical fruits, some flowers, poultry, electronic assembling, engineering, chemicals, cement, shipbuilding, banking, telecommunications, sea transport, air transport, auditing, software, insurance service, legal consultant service, health care;

-- <u>Group 3: Not competitive</u>—sugarcane, cotton, oil-generating plant, soyabean, corn, cow milk, pork products, steel.

However, this classification may be challenged, as some industries look misclassified. Moreover, it is not clear what analytical method is used to arrive at this conclusion. It is also reported that this classification is mainly based on the "effective" rate of protection (the tariff rate on the value-added component of each product). However, the current level of protection cannot be used to judge the potential of an industry in the future. A more careful approach should be used to evaluate the dynamic comparative advantage of a country. Among highly protected industries, we should distinguish truly infant industries from dying industries with no future.

Our alternative proposal is to accumulate good studies on individual industries. Rather than searching for general criteria or a simple indicator, in-depth studies of a dozen or so key industries should be conducted, one by one, on a continuous basis. At the same time, concrete policy issues for each individual industry should be identified and discussed among government officials, business leaders, industrial experts and international donors. This will be a time-consuming process, but without accumulating such specific information, useful promotion policy cannot be designed or implemented. Past industry studies by either domestic or foreign experts (including those by JICA and UNDP) have often been too general or superficial. However, in the past several years JICA has mobilized a number of Japanese experts and economists to study Viet Nam's steel industry from various angles, and important policy issues have now been identified (see my other paper). Such effort should also be extended to other industries so that policy makers will be able to prioritize industries from a broader perspective, not just from the viewpoint of one industry.

Tariff reduction strategy

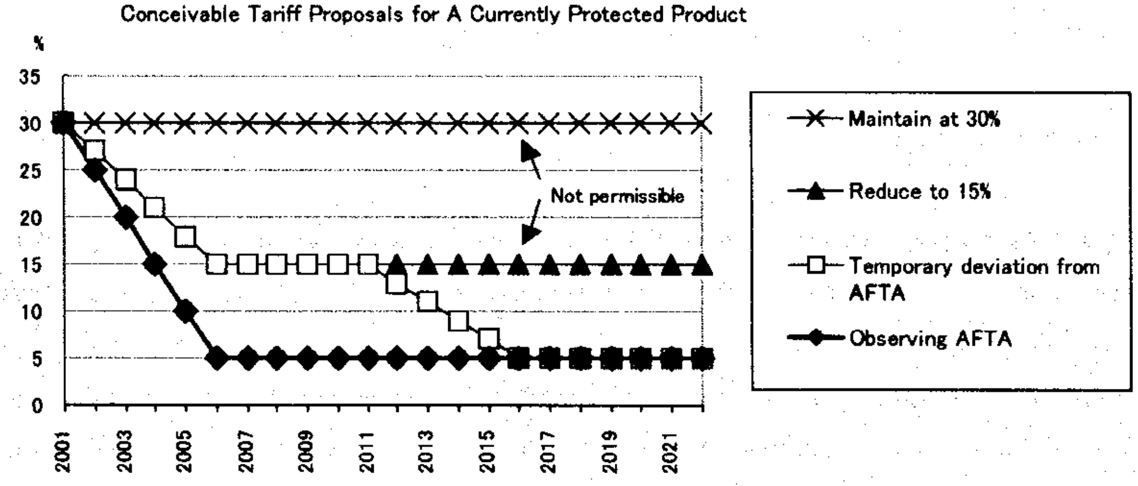
Before Viet Nam can effectively negotiate WTO entry, it has to prepare a tariff reduction schedule. But to do so, a long-term, concrete and mutually consistent policies for individual industries must be designed first. That in turn requires in-depth studies of each industry as mentioned above. Without such a national development strategy, individual tariff lines cannot be calculated or negotiated in a meaningful way. The currently prepared Five-Year Plan and ten-year strategy are too general. The problem with Viet Nam is that it has no such national development strategy even after several years of international integration.

Without clear tariff strategies for individual industries, we can only point out two general principles that Viet Nam must adhere to.

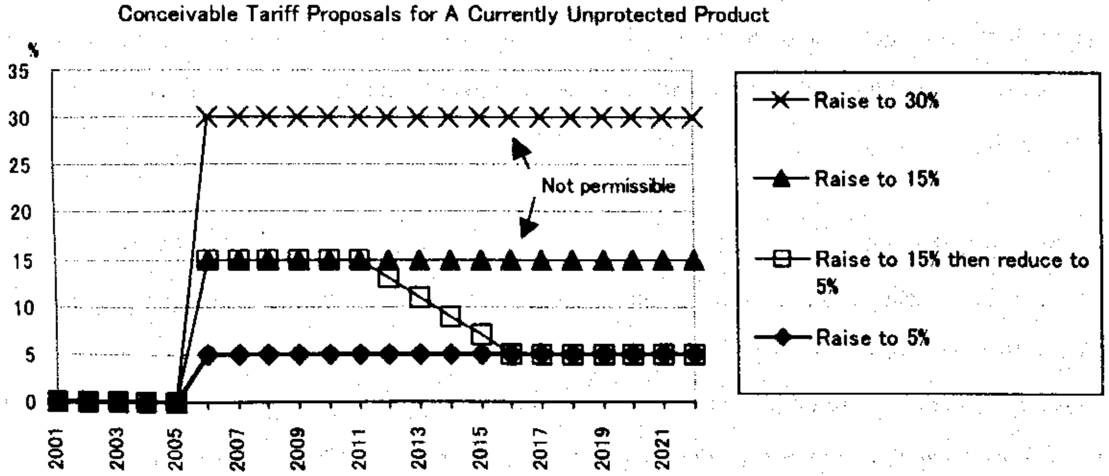
First, all non-tariff barriers (NTBs) including especially quantitative restrictions such as import bans and import licenses must be converted to corresponding tariffs as an initial step ("tariffication"). This task has been already started, but it would require a significant systemic change in Viet Nam's trade regime; removal of quantitative restrictions should not be offset by new hidden barriers such as operational procedure and domestic policy.

Second, under the regional obligation of AFTA and the global obligation of (future) WTO, permanent protection of any industry is out of question, and all industries should as a matter of principle expect free trade except for very special circumstances. These circumstances include temporary protection of a limited number of industries for the reason of either (i) industrial promotion under a very specific and realistic development plan; or (ii) severe injury of domestic producers due to sudden penetration of imports. In either case, protection must be conducted within the framework of AFTA and WTO.

Conceivable tariff proposals for a currently protected product are presented schematically in the diagram below (assume that the initial tariff is 30%). Among these, maintaining the tariff permanently above the AFTA ceiling is unlikely to be accepted by the international community, whether at 30% or 15%. The only permissible tariff proposal is either strictly adhering to AFTA or temporarily deviating from it, provided that such deviation is moderate and accompanied by a reasonable and concrete development strategy for that industry. Note that tariff rates in the diagram are for illustrative purposes only. It is not certain, for example, whether 15% can be accepted even for temporary protection.



For a currently unprotected product (assume that the initial tariff is zero since there is no corresponding domestic industry at present), if Viet Nam wishes to create that industry in the future, the tariff can be raised to a non-zero level. In that case also, similar constraints will apply. The new tariff must be 5% or less, or if going above that level, it must be moderate, temporary and accompanied by a reasonable and concrete development strategy.



In addition, the tariff system must be consistent across different industries. Protecting one industry often harms other industries which use the output of that industry. When industries are linked through input-output relations, the cascading pattern of tariffs (higher tariffs for downstream industries relative to upstream) is usually advisable.

WTO entry problem

As of June 2000, WTO has 137 member countries accounting for over 90 percent of global trade. For latecomer non-member countries, merits of joining WTO include (i) forestalling unfair commercial treatment by other countries; (ii) catalyst for domestic reforms; and (iii) access to WTO's dispute settlement mechanism. On the other hand, possible demerits are industrial collapse, unemployment, foreign dominance, etc. associated with rapid liberalization without adequate preparations, as discussed earlier. Generally speaking, today's WTO membership applicants lack necessary information or preparation to enter WTO. In a hasty attempt to join WTO, some countries even accept many unreasonable demands imposed by the existing members. For transition economies, understanding the principles of WTO, revising domestic laws, and implementing them will take enormous time and energy.

Moreover, countries wishing to enter WTO today face a number of additional difficulties.

First, the negotiation process tends to be costly, complex and prolonged. As an initial step, preparing the Memorandum and answering questions addressed to it already requires great effort. Bilateral negotiations with certain large member countries are excruciating. For very poor countries, negotiation and traveling costs of the official delegation are not negligible.

Second, demands from existing members are escalating. WTO does not stipulate the precise condition for entry, and everything is up to the negotiating parties. In the accession process, existing members are extremely powerful and applicants are disproportionately powerless, and this power imbalance leads to unreasonable demands being imposed on new members. Privatization, price liberalization, and export tax elimination are outside the jurisdiction of WTO, but they are nonetheless often required (called "WTO plus"). New members are regularly denied of waiver, exemption, or delayed execution enjoyed by existing LDC members. As a result, new members are forced to implement tariff reduction, TRIPs, TRIMs, export subsidy cuts, service trade liberalization, etc. much faster than the existing LDC members with similar levels of development.

Third, special treatment for low-income countries are often denied to new members. WTO is supposed to grant the following privileges to LDC members: (i) import protection for industrial development or against payments crisis (GATT article 18); (ii) access to developed country markets (GATT Part 4); and (iii) lower tariffs on LDC exports (GSP). However, in actual accession talks, these LDC "rights" are rarely conferred. Even the definition of "low-income country" is on the negotiation table, as in the case of China.

Fourth, with each passing year the conditions for entry are tightened. Thus, latecomers face the dilemma of joining now by yielding to unreasonable demands, or participating later with better preparations but with tougher requirements. Slow preparations as in the case of Viet Nam will make this dilemma even more serious.

Need for integration-friendly international environment

While most of the preparations for integration must be made on the Vietnamese side, the world economy must also change significantly to encourage and assist the integration of latecomer countries. At present, both in trade and finance, global markets are too unstable and competitive for latecomer countries to join safely. Moreover, the rules and mechanisms that regulate the world economy—including those of IMF, World Bank, WTO, ASEAN—are often unfair to latecomers (as in WTO entry negotiations discussed above), without consideration of the unique characteristics of each country (as in most IMF conditionality), or unable to prevent or cope with economic crises (in the Asian crisis, high interest rates and bold structural reforms during the panic may have worsened the situation).

More specifically, the following areas should be reformed before latecomer countries are asked to implement a rapid liberalization and integration program.

- Multiple integration rules should be applied to countries with different initial conditions and stages of development, rather than imposing uniform rules on all.
- Similarly, procedures which suppress the ownership and uniqueness of each country, such as an excessive application of CDF or IMF conditionality, should be avoided.
- Conditions under which latecomer countries can use temporary import protection must be clearly spelled out.
- Power imbalance between new entrants and existing members of WTO and other organizations should be corrected; there should be a "level playing field" for integration. Existing WTO members should not make unreasonable entry demands.
- Global financial and exchange rate instability must be regulated and reduced.
- IMF's capability to prevent and cope with currency crisis must be greatly improved.

Of course, Viet Nam alone cannot solve these global problems. Improving these systems is mainly the joint responsibility of large countries (including Japan) and international organizations. However, smaller countries can also raise issues and influence the global debate, as Malaysia did at the time of the Asian crisis. When developing countries have a legitimate cause for concern, they can jointly exert significant pressure on advanced countries. But to do so, the claimant country should have clear economic philosophy, good domestic policies and effective diplomacy.

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Policy Measures for Industrial Promotion and Foreign Direct Investment

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1. Background

The economic environment surrounding Viet Nam has drastically been changing. Since 1998, an unprecedented boom of foreign direct investment (FDI) has occurred among developed countries, and the economic activities have been globalized with the cost reduction of international logistics and telecommunications. FDI is extremely fastidious in choosing its destination, and the fruit of globalization tends to be distributed unevenly across countries and regions. Thus, less developed countries (LDCs) inevitably face the threat of marginalization from the world economic growth.

In the Asian economic crisis, the neighboring ASEAN countries have undertaken a drastic policy reform with a great sense of emergency. Rather than resisting the wave of globalization, they have boldly chosen a way to accommodate themselves to the new economic environment. As for the trade and FDI-related policies, they have clearly turned into more aggressive liberalization. Notably, they have promoted the ASEAN Free Trade Area (AFTA) scheme more vigorously and have removed various barriers and restrictions for incoming FDI.

In the neighboring ASEAN countries, micro economic industrial policies have shifted from the classical infant industry promotion with trade protection to other forms of industrial promotion policies. The neighbors start to seek possible policy instruments compatible with the Washington consensus advocated by the World Bank and the International Monetary Fund (IMF) and international policy discipline imposed by the World Trade Organization (WTO). They also think much of hosting FDI; they admit that affiliates of foreign firms are not a supplementary part of their industry but rather form a core of their economy at least in the short run. They carefully consider what multinational enterprises (MNEs) hope for and how they effectively capture spillover effects, resulting in the emphasis on agglomeration and information technology. They sensitively detect a change in MNEs' behavior; the cost reduction of service links among geographically remote production blocks enables MNEs to fragment their activities effectively. The market forces seek for both agglomeration and fragmentation.

The current LDCs are faced with new unprecedented economic environment. To meet a new challenge for industrialization in the wave of globalization, the role of government must also change. The traditional import substitution policies are not dead but require more careful planning with regard to the feasibility, incurred cost, and timing. Rather than considering trade protection, the government must pay more attention to preparing market-enhancing economic/social infrastructure and institutional arrangements. The government may want to sow seeds of agglomeration with a subtle touch. In addition, it is important to consider how to deal with FDI.

Viet Nam is no doubt a country with great human capability. However, it somewhat lagged behind in utilizing globalizing forces. The world may not be compassionate enough to wait for a gradual reform of Viet Nam. Viet Nam has already committed itself to entering the WTO accession process. Viet Nam has also decided to meet the obligation of AFTA in 2006, which will require the reduction of import tariffs to 0-5% as well as complete elimination of nontariff barriers (NTBs) for most of the traded commodities. Affiliates of foreign firms located in the ASEAN countries can also benefit by the preferential arrangements as far as they meet intra-regional content requirements of 40%.

This paper tries to present some materials potentially useful for constructive discussion when we consider how Viet Nam can deal with globalization. Rather than conducting an intensive, penetrating study on the Viet Nam's economy per se, we would like to survey the external economic environment and draw some policy implication for Viet Nam. The paper focuses on the issues of how far international policy discipline, particularly imposed by the WTO, limits industrial promotion policies. There is a trend that international policy discipline virtually steps into the territory of traditional domestic policy arena and makes discretionary room for industrial promotion. However, because of its history-dependent nature, the borderline between traditional "pure" domestic policy and international policy discipline is not uneven at all. We would like to check what sort of domestic policies is likely to be constrained and what is not by international policy discipline. Then, the discussion ends up with the issue of how to deal with FDI. FDI-related policies are by far most important for current LDCs to promote industrialization. We draw some anecdotes from neighboring countries as well as reviewing issues and problems pointed out by Japanese firms and provide some hints for constructing effective FDI-related policies.

2. Policy tools compatible with international policy discipline

The Washington consensus and the WTO's policy discipline are largely consistent with their advocacy of market-oriented institutional building and are in a desirable direction for LDCs in the long-run perspective. However, they often urge policy reform in great haste without taking into account adjustment costs and sequencing. In particular, international discipline of commercial policies imposed by the WTO is set as a rule and comes with a considerable enforceability backed up by effective dispute settlement mechanism.

However, they are not like a solid fortress at all. Since the discipline on international commercial policies has been developed from the traditional commodity trade discipline, the penetration into domestic policies is uneven and sporadic. In the following, we try to specify the maximal room for policy discretion conforming to the international standard.

(1) The WTO policy discipline

Multilateral trade negotiations obviously have a complicated logical structure. Economics theory says that removal of trade barriers raises the overall welfare of liberalizing country, particularly of the majority of consumers. However, in the political arena, possible loss of small number of import-competing producers is played up, and negotiators quite often work for domestic people with vested interest. A boost for trade liberalization comes from exporters hoping other countries' removal of trade barriers. As a result, negotiators behave very much like mercantilists, just like claiming that exports are good and imports are bad. They try to maximize other countries' import liberalization with minimal import liberalization (they call it "concession"!) of their own. Combined with idealistic motivation for worldwide liberalization, multilateral trade negotiations under the WTO are conducted under the rule of *reciprocity*; i.e., participating countries offer "concessions" to each other.[1]

The skewed incentive scheme of trade negotiators generates skewed environment for LDCs. Once an LDC becomes a WTO member country, it may utilize the reciprocity rule as well as collective negotiation forum so as to increase its negotiation power. Reciprocity is the rule of negotiation among WTO member countries, and thus LDCs at least potentially take no worse position in multilateral negotiations than in bilateral negotiations with world giants. On the other hand, newcomers such as Viet Nam always have hard time. Because the rule for member countries does not have to apply for nonmember countries, almost one-sided liberalization is requested in pre-accession bilateral negotiations. Recently in particular, liberalization requests have a form of so-called *WTO plus* (beyond the normal coverage of the WTO), which tends to demand even more than the incumbents have attained. Newcomers can be a member "on terms to be agreed" with the WTO (Marrakesh Agreement Article XI), which means that commitments regarded as WTO plus also become a part of the obligations (potentially subject to dispute settlement procedure) that newcomers must follow. The author thinks that this practice is problematic and potentially undermines the core spirit of the WTO. However, this is the reality. Newcomers must watch carefully what other recent newcomers committed themselves on. It is certainly unpleasant for countries in accession process to realize that the thrust of mercantilism comes with a sort of hypocritical fundamentalism.

However, note that policy rule or policy discipline of the WTO itself largely conforms to economics. At least, it is meant to be consistent with economic thought. Thus, policy makers in LDCs must be very careful in distinguishing between what has to be done as soon as possible and what does not have to. Economics tells us what is regarded as a principle to be followed and what can be dealt with on a case-by-case basis.

[1] Why multilateral trade negotiations are based on such skewed negotiation incentives is one of the hot topics among trade theorists. See Krugman (1997) and Bagwell and Staiger (2000) for example.

Policy discipline of the WTO is centered on *the non-discrimination principle*, which consists *of the most-favored-nation (MFN) treatment and the national treatment (NT)*. The former says that foreigner A and foreigner B must be treated equally while the latter claims that a domestic person (or good) and a foreign person (or good) must be treated equally. These are powerful notions from the viewpoint of economics that stresses the efficiency of resource allocation and are regarded as "a rule of thumb" in the sense that they must be followed in almost all situations. There are of course exceptional situations in which deviation from the principle is allowed, but in those cases, the existence of reasonable market failure must be demonstrated. In addition, *transparency requirement* is imposed in order to establish an effective and efficient market condition.

Beyond the non-discrimination principle and transparency requirement, economics does not issue a blank check. One of the confusing notions is *market access*. In the negotiation process of GATS (General Agreement on Trade in Services) during the Uruguay Round, the concept of market access was formally introduced in order to take care of quantitatively restrictive measures related to service trade (Article XVI).[2] The GATS defines NT in a narrow sense; the NT requirement means not to discriminate foreigners inside the domestic market, which does not cover possible discrimination at the national border. The concept of market access on the other hand covers the prohibition of discriminatory practices when foreign service providers are coming into a country's market. The GATS applies a positive list method for national treatment and market access and encourages liberalization in this direction. However, domestic regulations do sometimes have strong enough economic justification even if they result in deterring foreign entry. For example, the indigenous licensing system for accountants can work as a barrier to market access for foreign accountants but may be justified as reasonable domestic economic system. Whether economics endorses a domestic regulation must be judged on the case-by-case basis. In addition, the concept of market access has frequently been used in different contexts. In particular, market access often means the guaranteed foreign entry as a result, not just providing equal opportunity. In fact, economics has not given a rigorous definition to the concept of market access and thus does not treat market access as a rule of thumb.

Another problematic notion is *the convergence of economic institutions*. As the economy is more and more globalized, the convergence or harmonization of economic institutions becomes increasingly attractive. However, economics knows that each country's economic institutions have been formed in a history-dependent manner and thus often have economic justification to some extent. Economics does not advise us that all sorts of economic institutions must be commonized across countries. Again, whether the convergence of economic institutions is persuasive or not must be judged on the case-by-case basis.

[2] Article VI of GATS (Domestic Regulation), on the other hand, takes care of qualitatively restrictive measures in a loose manner.

Therefore, when the issue concerned is on market access or the convergence of economic institutions, do not hastily make concessions without thorough thought; it is still negotiable in many cases. We must first check whether the claim has enough support from economics or not. Then check whether it has already become a common sense in the world or not. If it does not sound appropriate for LDCs, get together with other LDCs to make your voice larger.

(2) Relationship between domestic policies and international policy discipline

The legal relationship between domestic policies and international policy discipline has clearly been established. In case of the WTO, the membership is based on an international treaty, and treaties are always placed under national constitutions that are directly endorsed by national sovereignty. In this sense, domestic policies always have priorities over international policy discipline. This structure is clearly different from the structure of "super-states" such as the EU Commission that is partially supported by direct votes of people in the region. Of course, international policy discipline itself is intended to change domestic policies in a proper way, but such changes must always be backed up by the endorsement of national sovereignty. Because a treaty arrangement among states is the legal background of the WTO, it does not physically force a state to follow its decisions even if it leaves room for possible retaliation. It simply says that "prompt compliance with recommendations or rulings of the dispute settlement body is essential in order to ensure effective resolution of disputes to the benefit of all Members" (Article XXI of Annex 2 of the Marrakesh Agreement). Each country can at any time reconsider the membership of the WTO if it finds the WTO too onerous or intolerable.

However, quick and efficient dispute settlement mechanism was established in the Uruguay Round, which provided the WTO strong virtual enforcement power. And, in reality, withdrawal from the WTO is too costly for most of the countries in the WTO, particularly for LDCs, even if they feel that their national sovereignty is partially intruded. In this sense, the WTO is becoming a sort of super-state. We cannot really predict whether this trend continues or not, though a number of economists start reconsidering the scope of the WTO rather conservatively.

Even if the WTO is going to be a sort of super-state, it cannot completely substitute for national governments for a number of reasons. One of the important differences between national governments and international organizations is on their objective functions. International policy discipline enforced by the WTO is almost entirely derived from the efficiency consideration. The primal goal is to optimize resource allocation of the world so as to maximize the world total pie. On the other hand, domestic policies typically have multiple objectives. The objective function usually includes not only the efficiency argument but also social consideration taking care of income distribution, regional development, minority policies, and others. This also means that domestic policies are more prone to being influenced by political economy compared with international policy discipline that has a much more simplistic objective function.

(3) Industrial promotion policies conforming to the WTO rule

Policy discipline of the WTO has strong history-dependent characteristics. Hence, even if the discipline basically conforms to economics, the borderline between "pure" domestic policies and international policy discipline is uneven. Some policies are strictly controlled by international policy discipline but others are not. As the GATT-WTO regime has evolved, the room for industrial promotion policies has also changed. In the following, we will review how far the WTO policy discipline restricts various types of commercial policies and specify the maximal room for discretionary policies for industrial promotion.

<u>Policies for merchandise trade</u>

The GATT has a long history of taking care of merchandise trade and thus naturally develops the most refined framework of liberalization for it. The key elements can be summarized as follows: first, Article XI of the 1947 GATT states the general elimination of quantitative restrictions. Economic theory says that quantitative restrictions such as import quotas are in general more distortive than price distortive measures such as import tariffs, and thus the GATT was written so as to be consistent with the theory on this matter. There are limited exceptions such as cases in which shortage of foodstuffs or other essential products must be avoided, cases in which standards or regulations for the classification, grading, or marketing of commodities are called for, cases in which restrictions are on agricultural or fisheries product for some specific purposes of domestic policies (GATT Article XI(2)), and cases in which it is necessary to safeguard external financial position and the balance of payments (GATT Article XII and Article XVIIIB for developing countries). Otherwise, the GATT asks member countries to eliminate quantitative restrictions with the possibility of switching into tariffs (we call it *tariffication*). Thus, we must say that quantitative restrictions cannot be long-lasting policy tools for protective purposes.

Second, the GATT does not request member countries to eliminate tariffs immediately. Rather, the GATT treats tariffs as the least distortive trade restriction and tries to switch other forms of measures into tariffs. The GATT asks member countries to attach to the Agreement the schedule of concessions, which includes the list of so-called conventional tariff rates. Conventional tariff rates are the maximal tariff rates that can be applied for the products of member countries. The proportion of commodity items that are bounded by the schedule of concessions is different across countries. Many Latin American countries set bound ratios at almost 100% while East Asian countries are often criticized for low bound ratios. For example, bound ratios are 89% in Korea, 92% in Indonesia, 70% in Thailand, 79% in Malaysia, 73% in Singapore, and 23% in Hong Kong (MITI (2000, p. 56)). Recently, new member countries are often requested to set zero or very low conventional tariff rates for almost all commodities. The negotiations over tariff reduction in the past were conducted over conventional tariff rates as well as bound ratios. After multiple negotiation rounds, tariffs have already lowered considerably though they have not reached zeros yet even in developed countries. We can still use tariffs for protective purposes for the coming five or ten years if negotiations work.[3]

Third, the GATT thinks much of various types of trade facilitation measures such as valuation for customs purposes (Article VII and the Agreement on Implementation of Article VII of the GATT 1994, and others), fees and formalities for trade (Article VIII), publication and administration of trade regulations (Article X), and others. The Marrakesh Agreement also included the Agreement on Technical Barriers to Trade (the TBT Agreement), and agricultural negotiations following the Uruguay Round concluded the Agreement on the Application of Sanitary and Phytosanitary Meaaures (the SPS Agreement). Actually, there are a number of complaints and disputes on these issues, and thus the GATT takes care of them in a deliberate manner. It sometimes goes beyond non-discrimination and transparency and steps into institutional convergence. It is in general difficult to manipulate these rhetoric for protective purposes.

Fourth, the GATT admits a few special types of tariffs when the condition meets. These are called "administered protective measures," which include antidumping duties (GATT Article VI and the Agreement on Implementation of Article VI of the GATT 1994), countervailing duties (GATT Articles VI and XVI), and safeguards (GATT Article XIX and the Agreement on Safeguards in the Marrakesh Agreement). Trade economists have long been criticizing both the structure and implementation of antidumping measures,[4] but recently in particular, the usage of them has spread over a number of LDCs.[5] It is understandable that LDCs would like to have some counter measures against "unfair" trade by other countries, and antidumping measures as well as countervailing measures can be effective tools for the purposes. However, they do not probably work as policy measures for promoting industries in the middle or long run. Safeguards can be used under some conditions even if exporting countries do not conduct unfair practices. However, the qualification for using this measure is known to be harder to attain. In addition, it is not suitable for industrial promotion in the middle and long run.

Policies for trade in services

The GATS was one of the most important attainments of the Uruguay Round and expanded to scope of GATT-WTO. The GATS specifies the coverage of service trade and sets up a framework of services trade liberalization. The GATS lists general obligations and disciplines including MFN (GATS Article II) and transparency (GATS Article III). As for the MFN treatment, member countries are obliged to list measures inconsistent with the MFN principle, using a so-called "negative list method." And then, as

[3] However, in case of Viet Nam, the AFTA obligation staring from 2006 would undermine any trial to use tariffs for protective purposes.

[4] See Finger (1993), Clarida (1996), Messerlin (1996), and Lipstein (1997) for example.

[5] See Miranda, Torres, and Ruiz (1998) and WTO (2000, p. 47) for the usage of antidumping measures by LDCs.

specific commitments, market access (GATS Article XVI) and national treatment (GATS Article XVII) are imposed. Member countries must submit the schedule that states the commitments for market access and national treatment by 155 sectors and 4 modes[6] with a "positive list method." After the Uruguay Round, negotiations were continued in the sectors of financial services (concluded in 1997), basic telecommunications (concluded in 1997), maritime transport services (not yet concluded), and movement of natural person (concluded in 1995).

The GATT Article XIX says that member countries must start negotiating over specific commitments for liberalization by the end of 1999. Because the new round has not started yet, service liberalization does not proceed quickly at this moment. From the viewpoint of newcomers such as Viet Nam, however, the pressure for liberalization would come from bilateral negotiations rather than discussions in WTO. What will be committed in the accession negotiation will determine the room for discretionary policies. Once the new round starts, however, we have to watch carefully what sort of liberalization obligation would come on trade in services.

Investment-related policies

In the era of globalization, the author believes that we should establish an essential set of multilateral policy discipline on FDI-related policies that includes transparency requirements, MFN and NT principles, a ban on some distortive performance requirements, and dispute settlement mechanism on the government-to-government basis. Of course, LDCs must be granted enough room for policy discretion on development purposes, but the current lack of multilateral policy principle as a rule of thumb seems rather to set obstacles to LDCs' effort to host FDI.[7] However, whether the investment rule will be a topic of the WTO new round or not is still under disputes. Countries with positive attitude for constructing multilateral investment rule include the European Commission, Japan, Korea, Hungary, Chile, and Switzerland. On the other hand, India, Pakistan, Malaysia, Egypt, and others are strongly opposed. FDI is asymmetric in nature. Investors are predominantly corporate firms of developed countries. On the other hand, it is mostly LDCs that should conduct substantial policy reform once investment rules are imposed. This asymmetry sometimes makes LDCs schizophrenic about investment rules. They would like to host FDI while they want to keep room for policy discretion.

There is no general investment rule at the multilateral level, and the binding, enforceable rule for FDI is limited to the Agreement on Trade-related Investment Measures (TRIMs) and a part of GATS. Although the TRIM Agreement includes articles on national treatment, the elimination of quantitative restrictions (Article II), and transparency requirements (Article VI), the coverage of TRIMs is virtually limited to

[6] Four modes are (i) cross-border supply, (ii) consumption abroad, (iii) commercial presence, and (iv) presence of natural persons.

[7] See Kimura (2000) in detail.

measures explicitly stated in the Illustrative List in the Annex. The list includes local contents requirements, trade balance requirements, foreign exchange regulations, and export restrictions as TRIMs not conforming to the WTO. This is obviously a very short list that covers a small subset of investment-related measures in general, but the discipline is enforced very strictly instead. Non-conforming TRIMs are to be completely removed in a short time period; in 2 years (after the Marrakesh Agreement becomes effective) in the case of a developed member country, 5 years in the case of a developing member country, and 7 years in the case of a least-developed member country (Article V). It seems pretty hard for LDCs to meet the time limit, and some of them have submitted request letters asking the extension of the transition period to the WTO (see Table 1).

Thus, policymakers of Viet Nam should notice that the TRIM obligation will come soon after the WTO accession. Investment-related policy measures other than those listed in the Annex of the TRIM Agreement, however, have large room for policy discretion.

An important trend in the international community is to establish bilateral investment treaties (BITs). At the bilateral level, treaties of friendship, commerce, and navigation (FCN) were traditionally concluded mainly between developed countries, that covered a wide range of bilateral economic, cultural, and political cooperation, including investment protection. No new FCN treaties have been concluded since the 1960s though. BITs began to be formed in the late 1950s and have recently been popular. BITs were traditionally concluded between a developed country and an LDC, but BITs between LDCs are also increasing recently.[8] According to the UNCTAD (2000b, p. 6), we had 1,856 BITs in the world at the end of 1999. The contents of BITs are mainly for investment protection. However, some BITs include articles promoting FDI liberalization such as NT before and after entry and the ban on performance requirements. The world trend is thus in the direction of liberalization though the general discipline is not yet established on the multilateral basis.

Subsidies and other domestic policies

Virtually all countries in the world provide subsidies as one of the instruments to accomplish their own policy objectives. Subsidies take various forms such as grants, tax exemption or reduction, low interest loans, capital provision, export credits, and others. Subsidies may distort competitive environment by protect domestic agencies, and thus the GATT-WTO imposes some restrictions on subsidies. However, because subsidies have strong nature of "pure" domestic policies, the WTO policy discipline takes a complicated form.

[8] UNCTAD is actively providing technical assistance and matchmaking services for LDCs to conclude BITs. One of the recent campaigns by UNCTAD with the support of the Government of Japan and the United Nations Development Programme (UNDP) was a two-week conference held in Sapporo, Japan in June 2000, where 12 LDCs initialed 22 BITs (UNCTAD (2000a)).

Table 2 is the summary of subsidy classification in the WTO for non-agricultural sectors. The WTO classifies subsidies into three categories: red, yellow, and green. Red subsidies are regarded as trade-distortive and are banned, which include export subsidies and subsidies upon the use of domestic over imported goods. As indicated in the lower part of the table, LDCs can be granted special treatment or longer transitional period after the WTO Agreement becomes effective. Yellow subsidies are not banned, but trading partners may impose countervailing duties if the condition meets. Green subsidies are not banned as well as not being subject to countervailing measures. Green subsidies include subsidies that are not specific, and subsidies that are specific but related to R&D, regional development, or environmental requirements (with some conditions). In addition, no matter what the type of subsidy is, member countries can seek remedies in the WTO.

There is thus a pretty wide scope of subsidies that conform to the WTO policy principle. One of the key elements is non-specificity. A subsidy is regarded as specific (i) if the access to the subsidy is limited to certain enterprises, (ii) if the access is limited to certain enterprises located within a designated geographical region, or (iii) if the subsidy is "red." There are many kinds of subsidies or policies that are not going to specific enterprises. Subsidies or policies for basic research, human resource development, or infrastructure development can in many cases be WTO-consistent policies serving for industrial development. Or, even if the final recipient of a subsidy is a specific enterprise, the government can establish objective criteria or conditions for the selection process so as to make the subsidy being "non-specific" (Agreement on Subsidies and Countervailing Measures Article II(1)(b)). In addition, specific subsidies for R&D, regional development, and environmental requirements are allowed under certain conditions (Article VIII(2)).

3. General direction to go

The paper reviewed the policy principle of the WTO and discussed the room for WTO-conforming policies for industrial promotion. Although we talked about the maximal room for policy discretion, it was not meant to encourage policymakers to fully utilize the freedom. On the contrary, we must stress that general direction must be liberalization and efficiency argument is important in the context of both static and dynamic resource allocation. We must try to minimize the utilization of artificial distortions, and once we go way out, we must logically justify the deviation as counter-distortionary policies. In addition, from the viewpoint of effective negotiation tactics, it would not be smart to fight everywhere on a long front line. Rather, with considering the overall balance, we had better narrow down the targeting and add more persuasive power in negotiation.

We must seriously consider the possible implication of AFTA. The neighboring countries of Viet Nam have developed quite different industrial structure compared with the Northeast Asian economies such as Japan, Korea, Taiwan. Notably, the presence of foreign affiliates has become by far heavier in the ASEAN countries than the Northeast Asian economies. Table 3 presents rough estimates of the weights of Affiliates of Japanese and American firms in the East Asian economies, using the data of the Japanese and U.S. statistics. Even in terms of value added, shares of affiliates of Japanese and U.S. firms in total are 20% in Singapore, 9% in Malaysia, 6% in Thailand, and 4% in the Philippines and Indonesia. Considering that the large proportion of FDI belongs to the manufacturing sector, we can say that the core of the manufacturing sector in the neighboring countries consists of foreign affiliates. The presence of foreign affiliates is even larger in terms of exports and imports. We must expect that a number of the foreign affiliates will surely clear the threshold of the 40% regional contents ratios, and Viet Nam will face their exports with tariffs of 0-5% from 2006.

Freer trade attracts FDI, and also the presence of foreign affiliates accelerates trade liberalization. Figure 1 presents recent changes in average tariff rates of the East Asian countries. These are not simple averages of tariff rates obtained from tariff schedules but ratios of total custom duty revenues to the value of imports. Of course, this indicator does not reflect prohibitive tariffs, but we can roughly read the height of actual trade barriers. The figures are surprisingly low and decreasing over time. In 1997 or 1998, the ratios are already less than 5% except the Philippines. Actually, Chile, which is known to accomplish bold trade liberalization, still has 7% in 1998. The low ratios mainly come from the heavy and increasing weights of foreign affiliates. 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.

Since the Asian economic crisis, the neighboring countries have even accelerated the liberalization of FDI-related policies. Viet Nam has to investigate how the neighboring countries treat incoming FDI. With considering the forthcoming obligation for the WTO and AFTA, Viet Nam may need to make a drastic decision for hosting FDI.

What motivates foreign capital to invest? Our observation suggests that investment incentives or preferential arrangements are not necessarily the key. Firms think more of the transparency, fairness, and predictability of FDI-related policies and administration. Table 4 presents the classification of issues as well as the number of complaints raised by Japanese firms (Business Council on Facilitation of Trade and Investment (2000a, 2000b)). Figures do not necessarily indicate the degree of seriousness or unfairness of issues. The larger the presence of Japanese firms is, the more issues are naturally raised. And also, their complaints sometimes come from their own narrow interest, rather than considering the overall welfare. Nevertheless, we can still obtain a rough idea of major obstacles Japanese investors are facing. In case of Viet Nam, many issues are pointed out particularly in "#23 systems, practices and administrative procedures" and "#24 underdeveloped legal system, sudden changes."

With a strong sense of emergency, the Board of Investment (BOI) of the Thai Government, which takes care of domestic and foreign investment incentives, has drastically reformed themselves in order to attract FDI. It has tried to attract FDI by establishing themselves as a "one-stop shop for services."[9] As a result, FDI inflows to Thailand increased from USD 2,405 million (1997) and USD 3,732 million (1998) to USD 7,449 million (1998) and USD 6,078 million (1999) (UNCTAD (2000b, p. 286)).

Also in the economic crisis, Malaysia imposed temporary restriction on capital outflows starting from September 1998. The international community initially criticized this policy measures, and the impact on FDI activities was expected to be strongly negative. However, we observed very few withdrawals of foreign affiliates from Malaysia though new investment stagnated. One of the untold stories in the background was close communications between government officials and foreign affiliates. Government officials took great effort to frequently visit foreign affiliates and their industrial associations and asked them whether or not they were experiencing any inconvenience in sending money back and forth. As a result, they successfully insulated real economy activities from the turmoil of financial sector.

These two anecdotes suggests that transparency, fairness, and predictability are the key for hosting FDI.

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[9] It is worth visiting the BOI's website (http://www.boi.go.th), which includes detailed explanation of FDI-related policies, useful news clips, a list of industrial estates, and others. The BOI claims that the website was awarded #5 website in the world (#1 in ASEAN) in *Corporate Location* magazines third annual review of national and state economic development agency websites.

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Table 1 Trade-related investment measures notified to the WTO

	Local content requirements	Trade balance requirements	Import restriction through foreign exchange control	Export restriction
Argentina	Am(e)	Am(e)		
Bolivia				O
Barbados	Ag			
Chile	Am(e)	Am(e)		
Colombia	Am, Ag(e)	Am, Ag(e)		
Costa Rica	O			
Cuba	Am, O			
Cyprus	Ag			
Dominican Rep.	O	Ag, O		
Ecuador	Am			
Indonesia	Am, Ag, O			
India	O			Am, Ag, O
Mexico	Am(e)			
Malaysia	Am(e)			
Pakistan	Am(e), O			
Peru	Ag			
Philippines	Am(e)		Am(e)	
Uganda*	O	O		
Romania	Am(e), O(e)			
Thailand	Am, Ag, O			
Uruguay			Am	
Venezuela	Am			
S. Africa	Am, Ag, O			
Egypt	?	?	?	?
Nigeria	?	?	?	?

Am: TRIM in automobile industry

Ag: TRIM in agriculture

O: TRIM in other fields

(e): Extension request has been submitted to the WTO.

*: Uganda is classified as a least-developed country, and thus the TRIM obligation will be effective on Jan. 1, 2002.

Source: MITI (2000, p. 167).

This table is originally appeared in Kimura (2000).

Table 2 Summary of subsidy classification by the WTO: for non-agricultural sectors

(1) Prohibited subsidies (red subsidies) [Part II]
- Export subsidies and subsidies upon the use of domestic over imported goods are prohibited. [Article III, Annex I]
- These subsidy shall be deemed to be specific. [Article II(3)]
- Special and differential treatment of developing country members. [Article XXVII]

(2) Actionable subsidies (yellow subsidies; not prohibited but possiblly subject to countervailing measures) [Part III]
- Subsidies which are specific, but neither red nor green.
- Notification of subsidies needed. [Article XXV (2)]

(3) Green subsidies (neither being prohibited nor being subject to countervailing measures)
- Subsidies which are not specific [Article II], or
  Subsidies which are specific [Article II], but one of the following holds [Article VIII]:
  Subsidies for research and development (in some conditions) [Article VIII(2)]
  Subsidies for regional development (in some conditions) [Article VIII(2)]
  Subsidies for environmental requirements (in some conditions)[Article VIII(2)]
- Notification is needed for subsidies which are specific. [Article XXV(2)]

Remedies (requesting consultations with other country members) are possible for red subsidies [Article IV], yellow subsidies [Article VII], and green subsidies [Article IX].

Definitions of some important concepts:

Specificity:

A subsidy is specific if the access is limited to certain enterprises [Article II(1)],
if it is limited to certain enterprises located within a designated geographical region [Article II(2)],
or if the subsidy is "red" [Article II(3)].

Countervailing measures [Part V]:

Imposition of countervailing duty that is a special duty levied for the purpose of offsetting any subsidy bestowed directly or indirectly upon the manufacture, production or export of any merchandise, as provided for in GATT Article VI(3).

Special and differential treatment of developing country members and transitional arrangements on the ban of "red" subsidies:

	Export subsidy	Subsidy upon the use of domestic over imported goods
Least-developed country	Not applied	Not applied for 8 years
Developing country in Annex VII (b) (GNP per capita is less than $1,000)	Not applied	Not applied for 5 years
Other developing country	Not applied for 8 years	Not applied for 5 years
Developed country	Not applied for 3 years	Not applied for 3 years
Transitional country	Not applied for 7 years	Not applied for 7 years

Numbers in [ ] indicate articles of the Agreement on Subsidies and Countervailing Measures in the Marrakesh Agreement.

Table 3 The significance of affiliates of Japanese and U.S. firms in the East Asian economies (1996)

(%)

	Value added		Employment		Exports		Imports	
	Affiliates of Japanese firms	Affiliates of U.S. firms	Affiliates of Japanese firms	Affiliates of U.S. firms	Affiliates of Japanese firms	Affiliates of U.S. firms	Affiliates of Japanese firms	Affiliates of U.S. firms
Korea	0.46	0.49	0.33	0.17	6.95	n.a.	6.34	n.a.
Hong Kong	5.24	1.91	2.66	3.18	17.02	17.17	16.38	n.a.
Singapore	11.90	7.69	4.73	5.68	33.17	55.13	33.38	n.a.
Malaysia	4.61	4.68	2.67	1.62	13.11	18.47	15.19	n.a.
Thailand	4.54	1.89	0.89	0.26	33.28	n.a.	29.76	n.a.
Philippines	1.56	2.60	0.34	0.24	13.98	31.02	9.70	n.a.
Indonesia	1.12	2.61	0.26	0.06	11.33	18.93	15.26	n.a.
China	0.42	0.26	0.05	0.02	3.82	5.32	4.51	n.a.

Affiliates of Japanese firms: Affiliates abroad with more than 10% Japanese ownership (except those whose parent firms are in finance & insurance or real estates). Data for 1996 F/Y.

Affiliates of U.S. firms: Affiliates abroad with more than 50% American ownership (neither parents nor affiliates are banks). Data for 1996.

Note that the ratio of returned questionnaires is as low as 59.1% for the data of affiliates of Japanese firms.

The definition of "value added": "sales minus purchases" for affiliates of Japanese firms, and "gross product" for affiliates of U.S. firms.

Value added and exports/imports for affiliates of Japanese firms are estimated by using the data for total NIEs and total ASEAN4.

Source: MITI (1999), U.S. Department of Commerce (1998), and IMF (2000).
This table is originally appeared in Kimura (2000).

Table 4 Barriers to trade and investment listed by Japanese firms

		ASEAN	Brunei	China	Hong Kong	India	Indonesia	Korea	Malaysia	Myanmar	Pakistan	Philippines	Singapore	Taiwan	Thailand
#1	Restrictions on entry and foreign ownership			11		4	10	5	9		1	4		2	2
#2	Regulations concerning domestic production ratios and local procurement ratios			5		5	3		3		1	2		1	3
#3	Export requirements			5		1		1				2		3	
#4	Withdrawal regulations			5		2	1								
#5	Restrictions in parts industry policies			1					1						1
#6	Preferential policies for foreign capital			6		2						1	1		
#7	Procedures for the operation of the Foreign Affiliate Law			1											4
#8	Investment recipient organization					1	1			1		1			7
#9	Export-import regulations; tariffs; customs clearance	7	1	35	1	11	14	11	14	3	4	12	1	13	9
#10	Regulations on activities in free trade areas and others			6		1	5		1					1	1
#11	Recovery of profit and technical fees; demands for technological transfer			3		6		3	2			1			
#12	Exchange controls			7		5	1	2	7	6	1	2		3	4
#13	Finance			7		7	4	2	3		1	4		3	4
#14	Taxation			18		13	12	4	4	3	3	9	1	5	12
#15	Price control						1								1
#16	Employment			11		6	9	3	7	4		4	6	7	5
#17	Infringement of intellectual property rights			6	1	1	4	4	3	1	1	3	5	6	10
#18	Demands for technology transfer			2		2			1						
#19	Industrial specifications and standards			6	1	1	1	2	2		1	1	2	4	2
#20	Monopoly								1						
#21	Land-holding restrictions			2		1	1		1	1		1	2		1
#22	Environmental pollution, waste disposal			1		1			1	1		3	1		4
#23	Systems, practices and administrative procedures			22		4	6	6	5	2	2	4	1	3	7
#24	Underdeveloped legal systems, sudden changes			10		2	2	1	1	3	3	2		1	1
#25	Government procurement					7			4		1				
#26	Other			9	3	15	7	2	5	8		5	2	4	6
Total		7	1	179	6	98	82	46	75	33	19	61	22	56	84

Table 4 Barriers to trade and investment listed by Japanese firms (cont.)

		Viet Nam	Australia	N.Z.	P.N.G.	NAFTA	Canada	Mexico	U.S.A.	Mercosur	Argentina	Brazil	Chile	Peru	Russia
#1	Restrictions on entry and foreign ownership	1	2				1	2	2			3	1		1
#2	Regulations concerning domestic production ratios and local procurement ratios	3				4		1	4	2	1	3			
#3	Export requirements	2						1			1	1			
#4	Withdrawal regulations														
#5	Restrictions in parts industry policies	1						2							
#6	Preferential policies for foreign capital	1					1								1
#7	Procedures for the operation of the Foreign Affiliate Law	2													
#8	Investment recipient organization	1													2
#9	Export-import regulations; tariffs; customs clearance	16	5	1		3	3	7	23	1	6	14	1	3	14
#10	Regulations on activities in free trade areas and others	1						1	1		1	3			
#11	Recovery of profit and technical fees; demands for technological transfer	1					1			1		4			
#12	Exchange controls	5			1			1				4			8
#13	Finance	4						1	2		1	2			5
#14	Taxation	8	5	1	1		8	12	6		4	6	2	2	14
#15	Price control														
#16	Employment	5	4	1			6	4	8			10		1	2
#17	Infringement of intellectual property rights	1	1	1					9		1			1	3
#18	Demands for technology transfer	4							1			1			
#19	Industrial specifications and standards	1	1	1			4	1	5	1				1	16
#20	Monopoly								1			1			
#21	Land-holding restrictions	3	1		1										
#22	Environmental pollution, waste disposal	1					1	1	2		1	1			
#23	Systems, practices and administrative procedures	7					1	5	2			1	1		12
#24	Underdeveloped legal systems, sudden changes	6					1	4				4	2		11
#25	Goverament procurement		1				1		6						2
#26	Other	7	2		1	1	4	3			1	10			7
Total		81	22	5	4	8	32	46	72	5	17	68	7	8	98

Table 4 Barriers to trade and investment listed by Japanese firms (cont.)

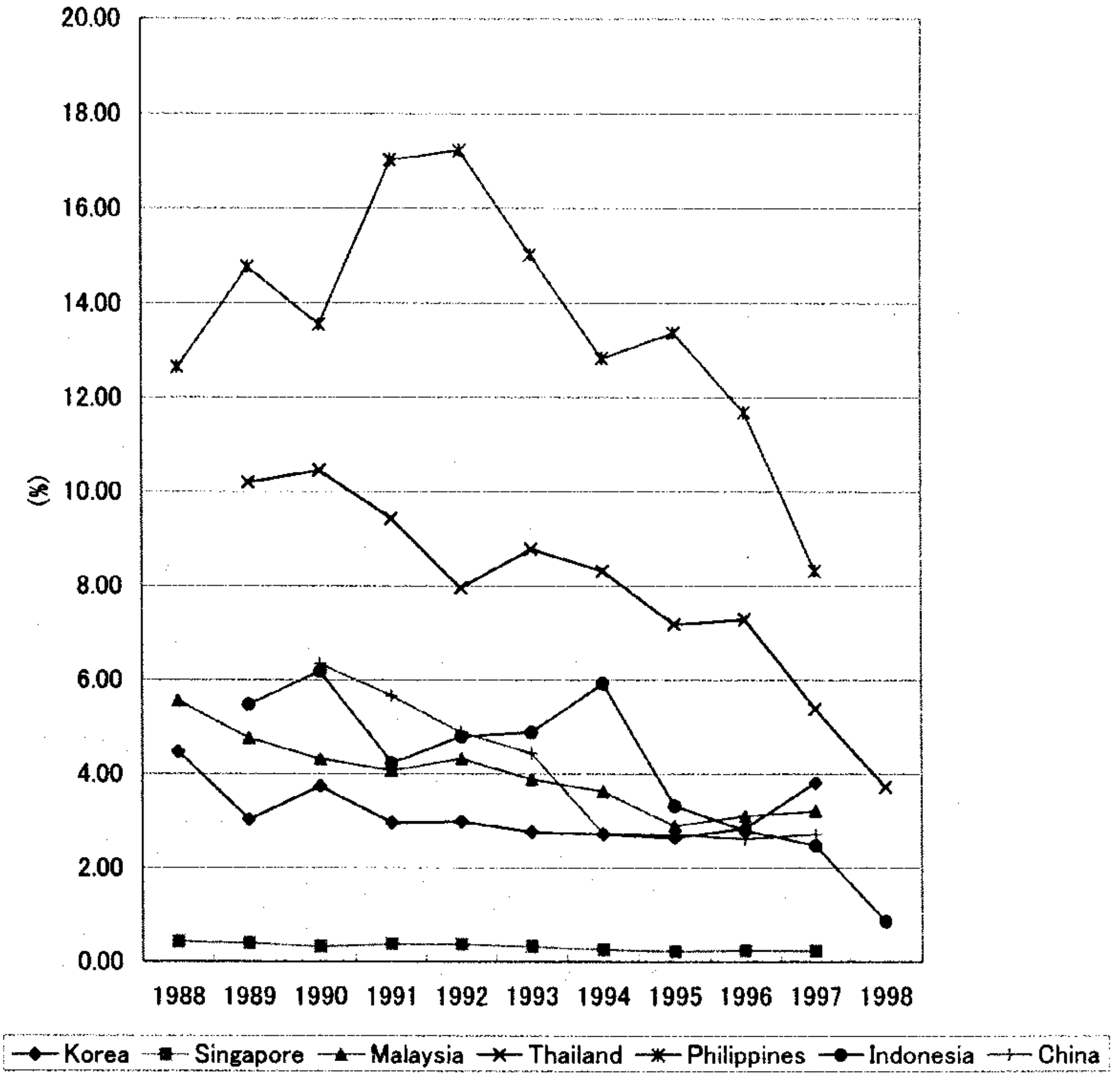
		EU	Austria	Belgium	U.K.	Denmark	Finland	France	Germany	Greece	Ireland	Italy	Luxembourg	Netherlands	Portugal
#1	Restrictions on entry and foreign ownership														
#2	Regulations concerning domestic production ratios and local procurement ratios	3			1										
#3	Export requirements														
#4	Withdrawal regulations														
#5	Restrictions in parts industry policies														
#6	Preferential policies for foreign capital									1		1			
#7	Procedures for the operation of the Foreign Affiliate Law														
#8	Investment recipient organization											1			
#9	Export-import regulations; tariffs; customs clearance	15		2	2			1				1			1
#10	Regulations on activities in free trade areas and others														
#11	Recovery of profit and technical fees; demands for technological transfer														
#12	Exchange controls	1			3										
#13	Finance								1			1			
#14	Taxation	4	1	3	3	2	1	5	7	2		5	1	1	
#15	Price control				1										
#16	Employment		3	3	5	1	1	7	7	4	2	6	3	4	6
#17	Infringement of intellectual property rights	1			3										
#18	Demands for technology transfer														
#19	Industrial specifications and standards	16			1			1	1					1	
#20	Monopoly				1										
#21	Land-holding restrictions														
#22	Environmental pollution, waste disposal	6						1	1	1		1			
#23	Systems, practices and administrative procedures	5			4				4	3		5		1	
#24	Underdeveloped legal systems, sudden changes	1			1					1					
#25	Government procurement														
#26	Other	1			3			2	1						
Total		53	4	8	28	3	2	17	22	12	2	21	4	7	7

Table 4 Barriers to trade and investment listed by Japanese firms (cont.)

		Spain	Sweden	Switzerland	Turkey	Belarus	Burgaria	Czech	Hungary	Poland	Romania	Slovakia	Slovenia	Ukraine	Yugoslavia
#1	Restrictions on entry and foreign ownership									1					
#2	Regulations concerning domestic production ratios and local procurement ratios				1				1	1					
#3	Export requirements														
#4	Withdrawal regulations	1													
#5	Restrictions in parts industry policies														
#6	Preferential policies for foreign capital							2	2	1	2	1			
#7	Procedures for the operation of the Foreign Affiliate Law														
#8	Investment recipient organization								1						
#9	Export-import regulations; tariffs; customs clearance	2			4		2	1	3	3	2	3	1		1
#10	Regulations on activities in free trade areas and others											1			
#11	Recovery of profit and technical fees; demands for technological transfer														
#12	Exchange controls				3			1	1	1					
#13	Finance								1	1					
#14	Taxation	1	1		1				2	2	4	2			
#15	Price control														
#16	Employment	6	2		2		1	3	1	2	1	3			
#17	Infringement of intellectual property rights			1											
#18	Demands for technology transfer														
#19	Industrial specifications and standards		1		1			1		1		1		1	
#20	Monopoly			1											
#21	Land-holding restrictions							1	1	1					
#22	Environmental pollution, waste disposal							1	1			1			
#23	Systems, practices and administrative procedures	3			2	1		5	5			1		1	
#24	Underdeveloped legal systems, sudden changes				1		1	3	3	3	1				
#25	Government procurement														
#26	Other				2			4	2	3		1			
Total		13	4	2	17	1	4	22	24	20	10	14	1	2	1

Figures in the table indicate the number of issues raised by Japanese firms.
Figures do not necessarily indicate the degree of seriousness or unfairness of issues.
Constructed from Business Council on Facilitation of Trade and Investment (2000a, 2000b).
This table originally appeared in Kimura (2000).

Figure 1 The incidence of customs duty as a percentage of import value in the East Asian countries



Source:

Customs duty: IMF (1999).

Imports (c.i.f.) and others: IMF (various years).