Chapter II

Foreign Direct Investment, Trade, and Vietnam's Interdependence in the APEC Region[1]

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1. Introduction

Economic interdependence in the Asia-Pacific region has grown noticeably stronger over the past few decades, manifested by rapid expansion of commodity trade and foreign direct investment (FDI). The increased interdependence has been accompanied by enhanced division of labor between economies in the region, involving developed, newly industrializing, and developing countries, as well as structural changes in economic activities in the countries involved. Especially in East and Southeast Asia, FDI is said to have played a particularly important role in the process of export-oriented industrialization. After boosting labor-intensive exports in low-technology activities as an initial step, a number of countries successfully broadened the local industrial base and shifted to medium- and high-technology activities.

Since Vietnam launched its Open Door Policy in the period of Doi Moi (renovation), it has actively sought to use international trade and foreign investment for its economic development objectives. Vietnam significantly strengthened its trade relations with Asian countries in the early 1990s, while increasing the share of labor-intensive manufactures in its export structure (Fujita 1999). At the same time, Vietnam has attracted attention from regional economies as a promising new production site with abundant low-cost labor, and it has rapidly integrated into the regional division of labor of manufacturing activities. Some Asian countries, including the East Asian NIEs, have been particularly active in relocating labor-intensive manufacturing processes to Vietnam. This suggests the possible linkage between FDI inflows and the initial phase

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of export-oriented industrialization in Vietnam, similar to the cases of other East Asian countries that preceded Vietnam in economic development.

Since the late 1990s, however, Vietnam has faced difficulties in promoting and utilizing FDI effectively because of the impact of the Asian currency crisis as well as structural problems in Vietnam's investment environment. It seems necessary at this stage to assess previous investment policies, and develop ways to promote FDI in the changing international environment.

This paper focuses on one of the most important benefits FDI may bring to developing countries, namely, boosting export-oriented industrialization. It attempts to examine to what extent FDI, especially from important APEC members, has contributed to promoting exports of manufactured products. In view of the difficulties Vietnam currently faces, the paper will also discuss how Vietnam can more effectively promote and utilize FDI for its development objectives. In addition, the paper will see how the country might benefit from multilateral, regional and bilateral frameworks for economic cooperation, including APEC.

The rest of the paper is organized as follows. Section 2 outlines Vietnam's FDI policies and its strategy to use FDI for its development objectives in the period of Doi Moi (renovation). The section also provides an overview of FDI inflows and its role in the Vietnamese economy in the 1990s. Section 3 analyzes how FDI has affected Vietnam's exports and imports. In addition to performing analysis based on aggregate trade and investment data, the author examines the impact of FDI from three major Asian investors, namely Taiwan, South Korea and Japan, on Vietnam's trade using bilateral trade and investment data, as well as a survey of Japanese-affiliated manufacturers in Vietnam. Section 4 discusses the future role of FDI in Vietnam and the potential roles for multilateral, regional and bilateral frameworks for economic cooperation, including APEC. Based on an on-site survey of Japanese-affiliates with successful export records, the author discusses which aspects of FDI Vietnam should focus on in the future and suggests what actions are needed for effective promotion and utilization of FDI. Section 5 provides the conclusions of the paper.

2. FDI in Vietnam in the Period of Doi Moi and Open Door Policy

2.1 Vietnam's FDI Regime in the Period of Open Door Policy

Vietnam's adoption of an open door policy in the context of Doi Moi, or renovation, marked a remarkable transition for the country's external economic relations, which had

previously relied heavily on barter trade with former CMEA countries and economic assistance from the former Soviet Union. After the collapse of the Soviet Union in 1991, Vietnam strengthened economic and political relations with Western capitalist nations and recovered its status in the international arena after a long period of isolation.

From the early years of Doi Moi, Vietnam's leadership attached prime importance to FDI as a mechanism to mobilize external resources for achieving national development objectives.[2] The Foreign Investment Law, issued as early as 1987, formed the basis for Vietnam's investment regime, and it was generally regarded as fairly liberal. For instance, it explicitly permitted wholly foreign-owned projects,[3] and most economic sectors were open to foreign investors. However, priority areas received official promotion, and they reflected Vietnam's development priorities, such as development of remote areas and effective utilization of natural resources.

Although these priority areas were modified as the 1987 Law went through several revisions in the 1990s[4], export-oriented projects have always received special promotion. In the early 1990s, the legislation also emphasized investment in labor-intensive industries. After the mid-1990s, however, Vietnam's intention to use FDI for development of key industries became evident.[5] In addition to officially promoting investment in key industries, Vietnamese authorities started to impose performance requirements, such as local contents requirements on investors in sectors like electronics and automobiles. These requirements attempt to foster the development of local supporting industries.[6]

In short, Vietnam has consistently promoted export-oriented investment in the 1990s, but new emphasis on development of key industries emerged after the mid-1990s, with a strong intention of using FDI for industrial policy objectives.

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[2] The emphasis was partly a result of Vietnam's recognition that it had been left further and further behind from other fast-growing economies in the region, which had been using FDI successfully for their development objectives (Le Dang Doanh 1996).

[3] Freeman (1994) notes that the Law was "deemed to be one of the most liberal in Southeast Asia, at least on paper". He points out that in practice, up until 1992 licenses for wholly foreign-owned projects were issued far more reluctantly than for joint venture projects and that only projects with significant benefits to the host country were gaining approval.

[4] For summaries of changes in Vietnam's FDI legislation in this period, see Oizumi (1997) and Kaneko (1999).

[5] This was particularly observed in the revision of the Foreign Investment Law in 1996. In the Law, 'key industries' specifically included metallurgy, basic chemicals, production machinery, petrochemical, fertilizers, electric components, automobiles and motorbike components.

[6] Kaneko (1999) notes that Vietnam's use of local contents requirements was substantially influenced by policies of other ASEAN countries that actively used FDI for their industrial policy objectives.

2.2 FDI Inflows and Its Role in the Vietnamese Economy

From the outset, the author would like to mention that it is very difficult to grasp the actual foreign investment situation in Vietnam because of the limited availability of reliable data. In the first place, official reports mainly provide data for approved projects. Available evidence suggests that the actual implementation ratio of licensed projects has been very low.[7] This study will rely mainly on data published by the Ministry of Planning and Investment (MPI), which is chiefly responsible for FDI data in Vietnam, but whenever necessary it will also refer to the database containing all the licensed projects (VCCI 1999) and IMF data (IMF 1999a, b). The Appendix provides detailed information about FDI data used in this study.

Table 1
FDI Regisitration and Implementation in Vietnam 1988-1998
Unit: million US$

	1988-90	1991	1992	1993	1994	1995	1996	1997	1998
Registered Capital									
New Investment	1,582	1,274	2,027	2,588	3,746	6,007	8,640	4,654	3,925
Capital Increase	0	8	47	230	515	1,308	756	1,142	876
Dissolved projects	24	240	402	79	217	477	1,023	352	2,426
Expired projects	0	1	14	16	0	1	75	1	19
Implemented Capital		213	394	1,099	1,946	2,671	2,646	3,250	1,956
Foreign capital		161	313	829	1,509	2,182	2,283	2,816	1,813
Domestic capital		52	81	270	437	489	363	434	143

Source: MPI (up to 1998), Saigon Times Daily Jan. 13 2000 (figures for 1999)

Table 1 shows the overall trend of FDI inflows in Vietnam. The amount of registered capital for licensed projects increased rapidly in the first half of the 1990s, which is generally referred to as the 'investment boom' period in Vietnam. Compared to the dramatic increase in registered capital, actual implementation remained far lower. The amount of registered capital peaked in the mid-1990s and dropped sharply after that. The table also shows that a substantial portion of the licensed projects were actually dissolved, and the amount of dissolved projects was particularly large in 1998 when the Asian economic crisis began to seriously impact on Vietnam.

[7] Kokko and Zejan (1996) lists various estimations of the implementation ratio of FDI projects using various data sources and covering different time frames; the results range from 14% to 30%. According to the author's calculations using 1988-1998 FDI data provided in IMF (1999a), the implementation ratio (defined here simply as the share of commitment to disbursement during the period) ranged from 17% for Singapore to 85% for the UK.

Table 2
Structure of FDI by Sector and Year of License Issuance
Unit: number of projects

		1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999 (1-8)	Total
Agriculture, Forestry Fishery		4	6	9	5	8	10	14	10	15	14	9	1	105
Industry	Food and Food Processing	1	8	13	26	28	30	43	58	44	34	35	5	325
	Leather Products	3	0	4	7	6	8	22	10	10	6	8	3	87
	Textiles and Garments	5	3	6	13	22	35	43	41	39	34	12	4	257
	Wood Produts	0	8	12	11	7	10	5	8	0	5	6	2	74
	Sub-total: Light Industries	9	19	35	57	63	83	113	117	93	79	61	14	743
	Cement, Glass and Non-metal Products	2	1	4	2	6	18	18	25	39	17	9	1	142
	Chemical Industry	1	6	2	6	11	19	25	33	39	47	19	2	210
	Electric, Electronic Products	4	2	7	5	6	10	18	30	21	27	11	2	143
	Machinery	2	4	4	8	6	7	24	17	29	17	11	2	131
	Metal Products	0	0	1	1	2	15	13	29	19	18	7	2	107
	Other Industry	1	3	7	9	12	26	28	30	21	36	16	1	190
	Sub-total: Heavy Industries	10	16	25	31	43	95	126	164	168	162	73	10	923
Mining		4	6	9	10	20	8	15	12	12	10	11	0	117
Services	Banking and Finance	0	1	1	0	10	4	4	6	8	3	1	2	40
	Construction and Real Estate	4	8	18	34	35	56	81	74	39	25	28	4	406
	Transport, Post, Telecommunication	3	11	5	6	7	12	13	11	11	10	10	1	100
	Other Services	2	3	6	9	9	13	16	28	23	41	45	12	207
Total		36	70	108	152	195	281	382	422	369	344	238	44	2641

Source: VCCI (1999)
Note: Excludes two projects whose dates of license issuance were not available on the database.

Tables 2 and **3** show the number of projects and the amount of investment capital for licensed projects by sectors. In the early years of Vietnam's Open Door Policy, licensed projects mainly concentrated in light industries, but agriculture, forestry and fishery and mining (mainly oil and gas) accounted for a substantial share of the investment capital. The share of light industries increased in the early 1990s, particularly textiles and garments and food processing. However, by the mid-1990s, the share of heavy industry and construction and real estate increased more rapidly, particularly in terms of the amount of investment capital. In the mid-1990s the construction and real estate sector and heavy industry accounted for 70 to 80% of total investment capital, which is partly due to the large size of projects in these sectors.

Table 3
Structure of Foreign Direct Investment Capital by Sector and Year of License Issuance
Unit: million US$

		1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999 (1-8)	Total
Agriculture, Forestry Fishery		120	107	51	34	20	43	72	32	51	46	21	1	598
Industry	Food and Food Processing	2	10	106	571	199	191	494	580	590	532	100	189	3564
	Textiles and Garments	3	18	35	46	111	543	189	446	204	280	53	3	1933
	Leather Products	6	0	6	7	31	20	251	21	183	18	28	20	592
	Wood Produts	0	4	12	15	9	21	10	23	0	15	22	3	134
	Sub-total: Light Industries	12	33	159	640	350	776	945	1070	977	844	202	215	6223
	Cement, Glass and Non-metal Products	2	2	4	5	338	127	136	603	952	604	40	2	2815
	Chemical Industry	3	29	5	8	69	64	145	526	230	358	330	5	1771
	Electric, Electronic Products	2	6	10	26	17	207	156	451	195	315	20	10	1417
	Machinery	1	17	2	114	140	48	113	614	523	85	101	5	1763
	Metal Products	0	0	2	0	6	131	211	293	134	81	74	5	938
	Other Industry	1	1	9	6	23	54	62	127	49	144	103	1	579
	Sub-total: Heavy Industries	10	56	31	159	593	631	823	2613	2085	1587	668	27	9283
Mining		149	99	181	178	699	163	150	79	145	140	143	0	2125
Services	Banking and Finance	0	0	15	0	140	50	45	80	96	17	15	4	463
	Construction and Real Estate	18	230	115	421	639	1818	2073	2792	4528	814	1083	83	14614
	Transport, Post, Telecommunication	39	33	294	37	40	42	77	365	719	749	695	3	3092
	Other Services	6	37	4	100	15	347	44	89	268	450	731	47	2136
Total		353	594	849	1570	2497	3868	4230	7120	8869	4647	3558	380	38535

Source: VCCI (1999)

Note: (1) Excludes Vietsovpetro project (Russian refinery joint venture licensed in 1998, with total investment capital of US$ 1,300 million.

(2) Excludes two projects whose dates of license issuance were not available on the database.

FDI in the construction and real estate sectors included large projects in hotels, office properties, apartments, and infrastructure, mainly targeting foreign residents and visitors in Vietnam. Meanwhile, investment in heavy industry mainly covered typical import substitution sectors such as cement and the automobile industry. These sectors attracted large amounts of FDI inflows during the 'investment boom' period. At the same time, however, they were the sectors most seriously affected by the Asian economic crisis, and they are said to have the largest amount of undisbursed commitments.[8]

[8] According to IMF (1999a), only 15% of total FDI disbursements during the 1994-98 period were in heavy industry and 17% were in the real estate sector.

Table 4
Structure of FDI Projects by Investing Country and Year of License Issuance
Unit: number of projects

	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999 (1-8)	Total
Taiwan		2	19	28	28	51	74	67	58	74	61	13	475
Hong Kong	7	24	28	28	40	36	58	33	17	18	25	6	320
Japan		5	6	11	9	18	34	71	70	59	12	5	300
South Korea	2		2	8	9	38	47	50	50	28	13	1	248
Singapore	2		5	6	17	31	32	37	40	36	30	2	238
France	4	10	3	9	11	16	20	14	14	20	15	1	137
Thailand	3	2	6	10	6	15	22	13	19	14	6	2	118
U.S.A	1	2	1		2	1	20	25	13	14	13	2	94
Australia	4	4	5	5	9	13	10	9	8	8	10	1	86
Malaysia			1	5	7	11	12	13	7	11	6	1	74
Russia	2	3	9	16	12	6	4	3	3		3		61
UK	3	6	0	2	5	1	3	8	2	3	4	0	37
Total	36	70	108	152	195	281	382	422	369	344	238	44	2641

Source: VCCI (1999)
Note: Excludes two projects from Japan whose dates of license issuance were not available on the database.

Table 5
Structure of Foreign Direct Investment Capital by Investing Country and Year of License Issuance
Unit: million US$

	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999 (1-8)	Total
Singapore	4	0	24	65	156	382	690	555	1440	936	1288	25	5566
Hong Kong	10	133	92	314	445	990	810	220	1208	264	806	169	5460
Taiwan	0	1	162	562	604	461	488	1224	955	269	226	54	5004
Japan	0	76	3	21	154	116	605	1402	778	772	129	11	4067
South Korea	4	0	1	79	137	526	381	644	836	554	54	0	3217
U.S.A	0	2	1	0	1	0	201	774	151	323	98	8	1558
Russia	23	43	24	51	36	30	14	12	5	0	6	0	1545
France	63	192	4	49	133	188	154	133	126	255	66	57	1423
Malaysia	0	0	0	78	27	570	149	109	93	248	15	4	1293
Australia	118	7	290	64	106	158	47	192	100	131	12	4	1228
Thailand	2	5	10	25	23	117	245	149	287	284	13	3	1164
UK	43	105	0	13	251	3	15	190	10	5	506	0	1139
Total	353	594	849	1570	2497	3868	4230	7120	8869	4647	3558	380	38535

Source: VCCI (1999)
Note: (1) Excludes Vietsovpetro project.
(2) Excludes two investment projects from Japan whose dates of license issuance were not available on the database.

Table 6
Sectoral Distribution of the Number of Licensed Projects by Investing Country
Unit: %

Sector		Tai-wan	Hong Kong	Japan	South Korea	Singa-pore	Fran-ce	Thai-land	U.S.A	Aust-ralia	Malay-sia	Russia	UK	Total
Agriculture, Forestry Fishery		7	5	2	1	3	4	12	3	2	0	5	3	4
Mining		1	1	3	2	3	6	4	6	9	7	11	38	4
Industry	Food and Food Processing	11	11	9	4	17	13	15	14	14	18	15	8	12
	Leather Products	7	4	0	13	0	0	1	0	1	0	3	0	3
	Textiles and Garments	17	11	10	23	3	5	5	2	1	5	7	5	10
	Wood Produts	5	3	1	2	1	2	1	1	3	4	3	0	3
	Sub-Total: Light Industries	40	29	21	42	21	20	22	17	20	27	28	14	28
	Cement, Glass & Non-metal Products	4	3	4	4	7	5	8	9	14	4	3	0	5
	Chemical Industry	9	2	8	7	8	9	12	10	6	12	8	5	8
	Electric, Electronic Products	6	3	9	10	5	4	3	7	2	4	5	0	5
	Machinery	6	2	13	4	2	2	5	7	3	3	11	0	5
	Metal Products	6	1	7	4	6	1	1	5	9	4	0	3	4
	Other Industry	11	3	8	12	4	6	8	4	1	9	7	3	7
	Sub-Total: Light Industries	42	14	49	42	32	26	36	43	36	36	34	11	35
Services	Banking and Finance	1	1	1	2	1	5	4	0	3	1	0	5	2
	Construction and Real Estate	6	36	10	6	24	19	11	13	10	15	10	11	15
	Transport, Post, Telecommunication	0	4	5	2	6	9	1	3	5	3	8	11	4
	Other Services	3	10	9	2	11	11	9	15	14	11	3	8	8
Total		100	100	100	100	100	100	100	100	100	100	100	100	100

Source: VCCI (1999)

Table 7
Sectoral Distribution of Investment Capital by Investing Country
Unit: %

		Singa-pore	Hong Kong	Tai-wan	Japan	South Korea	U.S.A	Russia	Fran-ce	Malay-sia	Aust-ralia	Thai-land	U.K	Total
Agriculture, Forestry Fishery		0	1	3	1	0	1	10	8	0	8	3	0	2
Industry	Food and Food Processing	12	6	13	2	2	7	23	16	5	20	12	1	9
	Leather Products	0	5	3	0	5	0	1	0	0	0	0	0	1
	Textiles and Garments	0	2	8	2	22	1	11	1	34	0	2	1	5
	Wood Produts	0	0	1	0	0	1	1	0	0	0	0	0	0
	Sub-Total: Light Industries	12	14	24	4	29	9	35	17	39	21	14	2	16
	Cement, Glass & Non-metal Products	5	1	19	16	5	15	2	1	9	3	8	0	7
	Chemical Industry	2	1	3	9	3	11	12	4	2	1	7	24	4
	Electric, Electronic Products	1	1	1	13	14	4	0	0	0	0	0	0	0
	Machinery	2	0	5	17	7	20	9	1	0	1	6	0	4
	Metal Products	2	1	2	4	5	2	0	0	2	13	1	0	2
	Other Industry	1	2	2	2	3	1	3	1	1	0	1	0	1
	Sub-Total: Heavy Industries	13	6	33	61	37	52	26	7	15	17	23	24	20
Mining		1	0	1	5	4	6	4	9	7	12	3	35	9
Services	Banking and Finance	1	0	0	1	2	0	0	8	1	3	5	2	1
	Construction and Real Estate	42	58	34	19	26	26	10	32	27	10	38	15	37
	Transport, Post, Telecommunication	29	1	0	8	1	0	14	2	0	26	0	21	8
	Other Services	1	19	4	1	0	6	1	16	3	3	13	0	5
Total		100	100	100	100	100	100	100	100	100	100	100	100	100

Source: VCCI (1999)
Note: Excludes Vietsovpetro project.

Tables 4 and **5** show the number of projects and the amount of investment capital for licensed projects by investing countries and the year of license issuance. In the late 1980s, FDI inflows came mainly from Australia, Russia, France, and the UK. Among Asian countries, Hong Kong and Taiwan started investing in Vietnam in the early 1990s, and investment from Singapore, Japan and South Korea began to increase a few years later. Looking at the total investment capital from 1988 to 1999, the top six investing countries are in East and Southeast Asia, which at least partly explains why FDI inflows into Vietnam fell so sharply in the years following the Asian economic crisis. The top investor in terms of project number during the 1988-1999 period was Taiwan, while it was third in terms of investment capital. And the country with the largest investment capital was Singapore. These rankings are explained by difference in sectoral distribution of FDI by investing countries.

Tables 6 and **7** show the sectoral structure of licensed projects for major investing countries. FDI from Singapore and Hong Kong was concentrated mainly in construction and the real estate sector. It accounted for a particularly large proportion of total investment capital, suggesting the large size of projects in this sector. Though the share of investment capital in light industries tended to be generally small, which was partly due to the small size of the projects, the share of textiles and garments and leather products industries was large in the case of Taiwan and South Korea. A

Table 8
Contribution of FDI to the Vietnamese Economy
Unit: million US$ (unless otherwise indicated)

	1991	1992	1993	1994	1995	1996	1997	1998
Turnover	149	208	449	952	1,872	2,583	3,605	3,505
Export	52	112	257	352	440	786	1,790	1,982
Share of the nation's total exports	2.5%	4.3%	8.6%	8.7%	8.1%	10.8%	19.5%	21.2%
Share of FIE's total turnover	34.9%	53.8%	57.2%	37.0%	23.5%	30.4%	49.7%	56.5%
Import	0	0	0	600	1,468	2,042	2,890	2,668
Share of the nation's total imports	0.0%	0.0%	0.0%	10.3%	18.0%	18.3%	24.9%	30.7%
Share of GDP		2%	3.60%	6.10%	6.30%	7.40%	9.10%	10.10%
Share of Gross Industrial Output					25%	27%	29%	
Growth of Industrial Output								
FIEs						22%	23%	23%
All Industrial Enterprises						14%	14%	12%
Employment (1,000 persons)							250	270
Share of total employment							0.7%	

Source: MPI, except for total trade values (used for calculation of FDI's share of trade) up to 1997 from General Statistical Office (1998) and IMF (1999b) for 1998; share of gross industrial output from General Statistical Office (various years)

number of other countries emphasized the food and food processing industry, including Singapore and Thailand. Japan's FDI to Vietnam was concentrated in heavy industry rather than light industry, particularly in terms of investment capital.

Table 8 shows FDI's contribution to the Vietnamese economy. The share of foreign invested enterprises (FIEs) in the nation's GDP, gross industrial output, and trade have increased steadily, even after the mid-1990s when FDI inflows started to fall. FIEs have played particularly important roles in industrial production and international trade. However, **Table 9** shows FIEs' share of industrial production has differed significantly across sectors. The FIEs' share was particularly high in sectors where Vietnam previously had almost no industrial base, such as computer and office equipment, telecommunication equipment, and motor vehicles. FIEs' share in garments and textiles, 20%, might seem unexpectedly low, but this is likely due to the dominance of subcontracting arrangements between foreign and Vietnamese firms rather than FDI. In these sectors, foreign firms tended to chose subcontracting arrangements because they significantly reduce the lengthy procedure and controls imposed on foreign firms

Table 9
Share of FIEs in Industrial Production by Sectors (1997)

Mining	Coal	0%
	Oil and gas	100%
Manufacturing	Food and beverage	21%
	Cigarettes and tobacco	1%
	Textile products	20%
	Garments	20%
	Leather tanning and processing	46%
	Wood and wood products	10%
	Paper and paper products	15%
	Coke and petroleum	0%
	Chemicals	21%
	Rubber and plastics	19%
	Non metallic products	13%
	Metallic	32%
	Metal products	25%
	Machinery and equipment	9%
	Computer and office equipment	100%
	Electric and electronic products	25%
	Radio TV teleccomunication equipment	75%
	Medical and accurate instruments	35%
	Assembling/repairing motor vehicles	71%
	Production reparing other means of transport	34%
	Furnitures	20%

Source: General Statistical Office (1998)

in the case of FDI.[9]

3. FDI-Trade Linkage in Vietnam

As discussed in Section 2.1, Vietnam has consistently regarded promotion of exports as one of the most important objectives of attracting FDI. In reality, however, the bulk of the licensed projects in the 1990s have been in heavy industries and service sectors, which have limited impact on exports. Then, to what extent has Vietnam succeeded in using FDI to boost exports?

This section attempts to analyze the impact of FDI on increasing manufacturing exports from Vietnam. Initially, the author will discuss the linkages between FDI and trade and the rationale for developing countries to promote export-oriented investments. Then, we will examine the impact of FDI on trade using aggregate investment and trade data as well as bilateral data for three Asian countries, namely Taiwan, South Korea, and Japan, which have been particularly active in investing in manufacturing sectors. Lastly, as bilateral data fail to show the impact of Japanese investment on Vietnam's trade, we will refer to JETRO's survey of Japanese-affiliated manufacturers in Vietnam for firm-level evidence.

3.1 Analytical Framework

A great deal of theoretical discussion and empirical analysis has examined the relation between FDI and trade. Much of the theoretical discussion has focused on whether FDI and trade are substitutes for each other or complementary to each other. Recently, the consensus seems to think that FDI-trade relations depend critically on the type of FDI, sector of economic activity, strategy of the multinational corporation, and other factors.[10]

Among the patterns of FDI-trade linkage developed by Katseli[11] (1997), the types of FDI relevant in the context of latecomer developing countries like Vietnam include the following:

(1) Labor-seeking FDI aims to utilize abundant low-cost labor to produce unskilled

[9] Ishida (1996) discusses cases of subcontracting arrangements between Japanese and Vietnamese firms in clothing and electronics industries.

[10] For an extensive discussion about interlinkages between FDI and trade, see UNCTAD (1996).

[11] In addition to the above four types of FDI, Katseli (1999) mentioned component-outsourcing investment and horizontal investment in differentiated products, but these do not seem relevant in the context of latecomer developing countries.

labor-intensive manufactures. Especially when the market of the host country is small, FDI tends to use the country as an export base, and thus the investment is export-promoting. Labor-seeking FDI also increases the imports of machinery, raw materials and intermediate inputs, especially at early stages of the project.[12] (In the context of Vietnam, investment in clothing industries is a typical example.)

(2) Market-seeking FDI takes place in order to penetrate into the host country's market, and thus the investment is import substituting. It also increases the imports of machinery, raw materials and intermediate inputs. (Investment in automobile assembly falls under this category.)

(3) Resource extracting FDI takes place in order to extract and export raw materials the host country possesses. It generates new export flows, but on the import side, the effect is ambiguous because imports of machinery and other intermediate inputs increase while imports of resources decrease. (Investment in oil exploitation is a typical example.)

(4) Service–related FDI, in most cases, affects trade indirectly through its effect on competitiveness, which is often a complicated process involving integration with the host country's productive sectors. (Investment in the financial sector is a typical example.)

Particularly in East Asian developing countries, labor-seeking FDI intended as an export base has come to play a dominant role over the past few decades (Chia 1995). It has enabled host countries to embark on export-oriented industrialization without having to go through the lengthy and costly process of building export industries from scratch. Export-oriented investment also provides significant market opportunities, especially when countries have limited domestic markets, means for earning foreign exchange, and opportunities to improve competitiveness through experience in foreign markets and to shift its dynamic comparative advantage.[13] In the course of export-oriented industrialization through FDI, however, imports of capital equipment, raw materials and intermediate inputs normally increase. This is necessary for producing high-quality products that can compete in international markets, especially during the early stages of investment. As the host country develops competitive local supporting industries, imports are expected to decrease.

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[12] Chia (1995) notes that the effects of FDI on trade vary with the lifecycle of the project. FDI effects evolve from an initial dependence on imported capital goods and intermediate inputs, a subsequent decline in imports of raw materials and intermediate inputs as local suppliers emerge, and finally leading to expanded exports of final products.

[13] For a discussion of developing countries' experiences in using FDI to boost export competitiveness, see UNCTAD (1999).

FDI's impact on trade in the Asia-Pacific region is analyzed in detail by Okuda in Chapter I of this volume, and a number of other econometric analyses have also confirmed a significant and positive impact of FDI on trade flows.[14] In this section, the author will attempt to analyze the impact of FDI on Vietnam's exports and imports, with a focus on FDI in the manufacturing sector, i.e., labor-intensive and market-seeking FDI of the classification presented above. Since the econometric approach faced difficulties,[15] we will depend on descriptive analysis of investment and trade data and a survey of firms.

3.2 Analysis using Aggregate and Bilateral Investment and Trade Data

As econometric analyses have shown, FDI is only one of numerous factors that determine trade flows, and the impact of FDI on trade has not been found to be particularly large.[16] Nevertheless, in a latecomer developing country at the initial stage of industrialization, FDI is expected to have substantial impact on exports of manufactures, particularly in sectors where the country has almost no previous industrial base. We will examine the impact of FDI on trade by referring to the changes in Vietnam's investment and trade structure using aggregate and bilateral data. Whereas it is the *stock* of FDI that is expected to affect trade flows, we will have to depend on data on approved projects for each year because of the lack of implementation data disaggregated by sectors. As mentioned in the previous section, the implementation ratio of FDI projects in Vietnam has been low,[17] and it has often

[14] Petri (1995), for example, performed regression analyses showing the significant impact of an inward FDI/GDP ratio on trade flows, defined as the sum of exports and imports.

[15] The author attempted a gravity analysis of trade flows in the APEC region, incorporating into the gravity model adopted in Fujita (1999) bilateral inward FDI stock as an explanatory variable only for trade flows involving Vietnam, because specifications and methods of compilation for bilateral FDI data vary across countries and thus they are not comparable with each other. The analysis did not produce any statistically significant results for either Vietnam's exports or imports. This may be partly due to the poor quality of Vietnam's FDI data, which do not offer figures for implemented projects broken down by years and investing country. However, the analysis in this study rather suggests that FDI in Vietnam has yet to make a substantial impact on boosting exports. In addition, other factors, such as third-country exports, make it difficult to observe bilateral FDI-trade linkage, which will be discussed in detail later in this paper.

[16] For example, in Chapter I of this volume, Okuda estimates the impact of inward FDI balance on the host country's exports. When the host country is a developing country, the coefficient for the balance of inward FDI on the country's exports is estimated to be around 0.1 for each year from 1995 to 1998. In other words, a 1% increase in the balance of inward FDI is expected to increase the host country's exports by only around 0.1%.

[17] According to the author's calculations using figures on cumulative FDI commitments and disbursements as of 1998 (IMF 1999a), the implementation ratio of projects in the industrial sector, which is the focus of our analysis, was around 31%. Within the industrial sector, the ratios for light industries (34%) and food industry (36%) were higher than heavy industries (29%). Among the

taken a few years for a project to start to operate after obtaining a license. The following investment data should be interpreted bearing these constraints in mind.

Table 10
Changes in the Structure of Vietnam's Trade 1991-1995

		Export		Import	
		1991	1995	1991	1995
Agricultural Products		39%	40%	9%	7%
A1	Crude Foodstuff	28%	28%	0%	0%
A2	Agricultural Materials	4%	3%	7%	5%
A3	Processed Food	7%	9%	2%	1%
Minerals		35%	24%	24%	13%
M1	Mineral Materials	0%	0%	0%	0%
M2	Mineral Fuels	34%	22%	2%	1%
M3	Petroleum Products	0%	2%	23%	12%
M4	Non-ferrous Metals	1%	0%	0%	0%
Labor-intensitve Manufactures		23%	32%	21%	32%
L1	Textiles	1%	2%	2%	2%
L2	Clothing	7%	20%	2%	4%
L3	Leather and Footwear	1%	5%	1%	2%
L4	Furniture and Wood Products	0%	2%	0%	0%
L5	Rubber and Plastic Products	1%	2%	2%	4%
L6	Miscellaneous Manufactures	13%	2%	15%	20%
Capital-intensive Manufactures		1%	3%	19%	22%
C1	Beverage and Tobacco	0%	0%	3%	1%
C2	Pulp, Paper and Paper Products	0%	0%	0%	1%
C3	Chemicals	0%	0%	14%	12%
C4	Glass and Non-metal Products	0%	0%	0%	2%
C5	Iron and Steel	0%	0%	1%	5%
C6	Metal Products	1%	2%	1%	1%
Machinery		1%	1%	26%	27%
T1	Industrial Materials	1%	0%	23%	17%
T2	Electric Machinery	0%	0%	2%	2%
T3	Motor Vehicles	0%	0%	1%	4%
T4	Other Transport Equipment	1%	0%	1%	3%
T5	Precision Instruments	0%	0%	0%	0%

Source: Fujita (1999)

Note: The commodity classification is based on Standard International Trade Classification (SITC). For details, see Appendix 1 in Fujita (1999).

3.2.1 Structure of Investment and Trade at the Aggregate Level

Table 10 shows the changes in Vietnam's trade structure between 1991 and 1995.[18]

three countries selected for case studies in Section 3.2.2, FDI from Japan had the highest implementation ratio (37%), followed by Taiwan (34%) and South Korea (32%).

[18] For more data and discussion on the changes in Vietnam's trade structure in the 1990s, see Fujita (1999).

The labor-intensive manufactures' share of total exports increased rapidly, while the share of minerals, particularly crude oil, decreased. Capital-intensive manufactures and machinery, as well as miscellaneous manufactures, continued to dominate Vietnam's imports. Although we cannot analyze Vietnam's trade structure after 1995 according to the commodity classification used in Table 10[19], available evidence suggests that the same trend continued or even intensified in the latter half of the 1990s. Vietnam's trade statistics show that the light industrial and handicraft goods' share of total exports increased from 28% in 1995 to 37% in 1997. Meanwhile, the equipment, machinery, and instrument's share of total imports increased from 26% in 1995 to 30% in 1997, and fuels and raw materials' share of total imports also increased from 58% in 1995 to 60% in 1997 (General Statistical Office, 1998).

Can we observe any influence of FDI on the above changes in the trade structure? FDI seems to have had limited effects on increasing labor-intensive exports. Compared to a remarkable increase in exports of labor-intensive products, especially clothing, and footwear, those sectors' share of total investments has remained rather small (**Tables 2** and **3**). This is because domestic firms were operating in these relatively simple manufacturing sectors, which actually had a rather limited presence of foreign investors (**Table 9**). In these sectors, foreign firms commonly undertake subcontracting arrangements with Vietnamese firms, as discussed in Section 2.2.

In terms of imports, the impact of FDI is also difficult to identify. The increased share of capital- and technology-intensive products reflects the need of both labor-seeking and market-seeking FIEs as well as domestic firms for machinery, industrial materials and intermediate inputs. While the increase in market-seeking FDI in heavy industry in the mid-1990s is expected to decrease imports of heavy industrial products through import substitution, such an effect cannot be observed. In the first place, evidence suggests a substantial portion of the licensed projects in these sectors have not been implemented. And even if implemented, it takes time before the import substitution effect appears, and it may be offset by the short-run impact of increased imports of capital equipment.

In sum, FDI's contribution to export-oriented industrialization seems to be rather limited, and the impact of FDI on both exports and imports was difficult to identify at the aggregate level. The above analysis suggests the need to examine FDI-trade linkage at a more disaggregated level. The next step, therefore, is to examine the structure of bilateral trade and investment between Vietnam and some of its important

[19] This is because of the lack of trade data classified according to the Standard International Trade Classification.

trade/investment partners, as the patterns of FDI-trade linkage will likely vary across partners.

3.2.2 Structure of Investment and Trade – Bilateral Relationship between Vietnam and Selected Partners

For further analysis of bilateral trade and investment structure, the author has selected three Asian countries, namely Taiwan, South Korea, and Japan, as case studies. They are all among the top investors in Vietnam, and their investment into Vietnam has focused on manufacturing, which is the focus of this study. In addition, they are all important APEC members, playing important roles in trade and investment in the Asia-Pacific region. As discussed in Section 2, Taiwan and South Korea have invested actively in typical labor-intensive industries, while Japanese investment has emphasized heavy industries. The analysis of bilateral investment and trade structure is expected to show differences between investments by newly industrializing economies, whose level of economic development is closer to that of the host country, and investments by an industrialized country, with a much wider gap with the host country in the level of economic development.

As for trade data, we will depend on each partner's national statistics because Vietnam does not provide trade data classified by country and commodity. All three countries selected for case studies publish their trade data according to the Harmonized Systems (HS) classification, so the data will be compiled with HS 2-digit headings. As for FDI data, we will depend on the database of licensed projects (VCCI 1999).

Taiwan

Tables 11 and **12** show Taiwan's investment and trade structure with Vietnam. The impact of FDI on Vietnam's exports to Taiwan is clearly observed in some labor-intensive industries. Wood and wooden products dominated Vietnam's exports to Taiwan in the early 1990s, and in fact, this sector had played an important role in Taiwan's FDI to Vietnam for a few years since 1989.[20] In the mid-1990s, the share of wood products decreased and the share of apparel, textiles, and footwear increased rapidly, accounting for over 25% of total exports in 1998. This corresponds with the increase in Taiwan's FDI in those sectors in the early to mid-1990s. Although the share of these light industries in terms of investment capital has been relatively small, they have constantly accounted for around one-third of Taiwan's total FDI in terms of

[20] Though the investment capital in the wood processing industry was small during this period, one needs to consider the relatively small size of projects in this sector. According to the data provided by VCCI (1999), the average size of projects, i.e., total investment capital per project, varied widely across sectors. In fact, the wood processing industry had the smallest value of average investment capital per project, US$ 1.8 million, while the overall average was US$ 14.6 million.

the number of projects.

Table 11
Composition of Taiwan's FDI by Sector and Year of License Issuance
(1) Number of Projects

Sector		1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999 (1-8)	Total
Agriculture, Forestry Fishery		0	1	2	2	4	4	6	5	4	5	0	33
Mining		0	0	1	1	0	2	0	0	1	2	0	7
Industry	Food and Food Processing	0	5	3	4	5	6	8	4	6	10	2	53
	Leather Products	0	2	3	4	3	3	2	6	2	6	2	33
	Textiles and Garments	0	1	3	4	12	13	16	10	15	6	1	81
	Wood Produts	2	3	5	2	2	0	2	0	3	3	2	24
	Sub-total: Light Industries	2	11	14	14	22	22	28	20	26	25	7	191
	Cement, Glass & Non-metal Products	0	1	0	1	2	3	1	6	4	2	0	20
	Chemical Industry	0	0	1	2	5	4	6	9	14	3	1	45
	Electric, Electronic Products	0	3	2	2	3	3	4	3	0	7	0	27
	Machinery	0	0	0	1	0	14	1	5	3	4	1	29
	Metal Products	0	0	0	0	3	3	9	3	4	4	1	27
	Other Industry	0	1	2	1	7	11	6	6	11	5	1	51
	Sub-total: Heavy Industries	0	5	5	7	20	38	27	32	36	25	4	199
Services	Banking and Finance	0	0	0	0	1	0	1	0	0	0	1	3
	Construction and Real Estate	0	2	3	3	3	7	5	1	2	3	0	29
	Transport, Post, Telecommunication	0	0	1	0	0	0	0	0	0	0	0	1
	Other Services	0	0	2	1	1	1	0	0	5	1	1	12
Total		2	19	28	28	51	74	67	58	74	61	13	475

(2) Total Investment Capital
Unit: million US$

Sector		1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999 (1-8)	Total
Agriculture, Forestry Fishery		0	30	31	5	14	11	16	14	21	6	0	147
Mining		0	0	1	2	0	17	0	0	35	8	0	63
Industry	Food and Food Processing	0	89	287	45	12	122	30	10	19	37	5	657
	Leather Products	0	5	5	24	3	7	5	37	5	23	20	133
	Textiles and Garments	0	10	9	14	67	88	26	92	38	45	1	389
	Wood Produts	1	2	6	3	2	0	4	0	7	6	3	32
	Sub-total: Light Industries	1	105	306	86	85	216	65	139	68	111	29	1212
	Cement, Glass & Non-metal Products	0	2	0	288	25	45	2	550	21	3	0	935
	Chemical Industry	0	0	1	12	16	9	41	29	52	8	1	166
	Electric, Electronic Products	0	4	2	9	7	13	11	11	0	17	0	73
	Machinery	0	0	0	120	0	38	1	62	16	10	1	248
	Metal Products	0	0	0	0	10	3	34	50	13	8	2	119
	Other Industry	0	1	3	4	13	16	27	12	23	9	1	110
	Sub-total: Heavy Industries	0	7	6	432	70	123	116	713	124	54	5	1651
Services	Banking and Finance	0	0	0	0	15	0	5	0	0	0	0	20
	Construction and Real Estate	0	19	110	74	255	118	1022	89	4	17	0	1708
	Transport, Post, Telecommunication	0	0	98	5	23	2	0	0	17	29	20	194
	Other Services	0	0	10	0	0	0	0	0	0	0	0	10
Total		1	162	562	604	461	488	1224	955	269	226	54	5004

Source: VCCI (1999)

Table 12
Trade Structure between Vietnam and Taiwan 1989-1998
Unit: % of total export/import value
(1) Vietnam's Main Export Items to Taiwan

HS	Heading	1991	1992	1993	1994	1995	1996	1997	1998
5	Products of animal origin, NESOI	10.4	8.8	4.7	4.4	4.7	4.2	4.6	2.9
7	Edible vegetables & certain roots & tubes	0.1	0.6	0.5	2.3	2.0	2.8	2.3	3.0
8	Edible fruit & nuts; citrus fruit or melon peel	0.8	1.3	1.2	1.1	1.2	1.2	0.9	1.2
9	Coffee, tea, mate & spices	2.7	2.9	3.1	2.6	2.1	2.1	1.7	2.0
12	Oil seeds etc,; misc grain seed, fruit, plant etc.	4.5	3.4	3.3	0.9	0.7	1.2	3.1	2.3
20	Prep vegetables, fruit, nuts or other plant parts	0.3	0.6	1.0	1.8	1.9	1.9	1.4	1.5
25	Salt; sulfur; earth & stone; lime & cement plaster	1.5	1.3	1.4	1.4	0.9	1.0	0.9	1.3
27	Mineral fuel, oil etc.; bitumen subst., mineral wax	3.2	2.7	1.9	1.6	1.7	1.3	0.9	1.1
29	Organic chemicals	0.0	0.1	0.0	0.1	0.0	1.0	3.4	4.6
40	Rubber and articles thereof	0.7	1.2	1.9	2.4	4.6	5.0	4.4	3.2
44	Wood and articles of wood; wood charcoal	52.3	54.4	45.1	34.0	28.1	17.1	12.5	10.2
48	Paper & paperboard & articles (inc papr pulp artl)	0.7	1.7	2.4	3.3	4.2	5.1	4.4	3.7
61	Apparel articles and accessories, knit or crochet	0.4	0.7	6.0	4.9	2.6	3.2	8.6	9.1
62	Apparel articles and accessories, not knit etc.	1.1	0.9	4.6	7.5	7.7	11.4	10.2	11.3
63	Textile art NESOR; needlecraft sets; worn text art	0.2	0.9	1.0	1.2	1.9	2.1	2.3	2.6
64	Footwear, gaiters etc. and parts thereof	0.1	0.2	0.4	0.8	0.9	2.4	4.7	2.9
72	Iron and steel	4.0	1.3	0.1	1.0	0.7	0.2	0.2	0.3
73	Articles of iron and steel	0.0	0.3	1.7	1.8	1.3	1.5	1.1	1.0
85	Electric machinery etc.; sound equip; TV equip; pts	0.0	0.0	0.1	0.4	0.3	0.7	2.2	2.5
94	Furniture; bedding etc., lamps NESOI etc., prefab bd	2.3	4.9	10.0	14.5	14.7	13.6	11.2	10.1

(2) Vietnam's Main Import Items from Taiwan

HS	Heading	1991	1992	1993	1994	1995	1996	1997	1998
27	Mineral fue, oil, etc.; bitumen subst; mineral wax	1.7	3.3	2.3	0.5	0.8	1.6	1.7	1.1
29	Organic chemicals	6.4	4.8	4.4	4.6	1.2	0.5	0.6	0.7
32	Tanning & dye ext etc; dye, paint, putty etc; inks	1.1	1.6	1.1	1.2	1.3	1.7	2.0	2.2
39	Plastics and articles thereof	3.1	4.1	3.3	4.2	4.9	5.9	5.9	6.2
40	Rubbers and articules thereof	1.9	1.9	1.5	1.4	1.5	1.6	1.5	1.3
41	Raw hides and skins (no furskins) and leather	0.0	0.0	0.4	2.1	3.9	4.5	5.5	5.8
48	Paper & paperboard & articles (incl papr pulp artl)	3.4	3.8	3.5	4.2	4.5	4.8	3.7	3.5
52	Cotton, including yarn and woven fabric thereof	4.8	3.0	2.6	2.5	2.1	2.3	2.6	2.4
54	Manmade filaments, including yarns& woven fabrics	25.7	20.2	14.1	11.7	8.8	8.8	9.3	9.8
55	Manmade staple fibers, incl yarns & woven fabrics	15.7	9.2	5.1	6.2	8.6	6.5	4.7	4.8
56	Wadding, felt etc.; sp yarn; twine, ropers etc.	1.0	1.1	0.7	1.0	1.0	1.4	1.5	1.6
58	Spec woven fabricsl tufted fab; lace; tapestries, etc.	0.4	0.5	0.7	0.7	0.6	0.8	1.1	1.5
59	Impregnated etc text fabrics; tex art for industry	2.4	2.2	3.5	5.4	5.6	6.5	6.5	6.4
60	Knitted or crocheted fabrics	3.5	3.8	2.4	3.8	3.7	3.9	3.3	3.4
64	Footwear, gaiters etc. and parts thereof	2.2	7.1	9.1	7.1	6.5	5.3	4.7	4.0
72	Iron and steel	0.3	2.0	4.3	2.0	3.0	4.7	6.3	5.8
73	Articles of iron and stel	0.5	0.6	1.5	1.6	2.0	2.3	2.3	2.0
84	Nuclear reactors, boilers, machiery etc.; parts	14.2	15.4	18.1	17.0	17.7	16.7	16.1	15.3
85	Electronic machinery etc; sound equipl TV equip, pts	1.8	2.9	7.1	5.4	5.0	4.1	5.1	5.7
87	Vehicles, except railway or tramway, and parts etc.	0.2	1.7	3.3	4.8	5.0	3.1	2.1	3.3

Source: Statistical Department, Directorate General of Customs, Ministry of Finance, "Monthly Statistics of Exports/Imports: The Republic of China, Taiwan District", various issues

Table 13
Structure of South Korea's FDI by Sector and Year of License Issuance
(1) Number of Projects

Sector		1988	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999 (1-8)	Total
Agriculture, Forestry Fishery		0	0	0	1	0	0	1	1	0	0	0	3
Mining		0	0	0	1	0	1	0	1	1	1	0	5
Industry	Food and Food Processing	0	0	1	0	1	2	2	3	1	1	0	11
	Leather Products	1	0	1	1	5	14	6	1	2	1	1	33
	Textiles and Garments	1	0	2	3	10	11	9	9	8	4	0	57
	Wood Produts	0	1	0	0	0	2	0	0	1	0	0	4
	Sub-total: Light Industries	2	1	4	4	16	29	17	13	12	6	1	105
	Cement, Glass & Non-metal Products	0	0	0	0	2	1	3	3	1	0	0	10
	Chemical Industry	0	0	0	0	4	1	3	6	2	1	0	17
	Electric, Electronic Products	0	0	0	1	3	3	9	5	3	1	0	25
	Machinery	0	1	2	0	3	1	0	2	2	0	0	11
	Metal Products	0	0	0	1	1	1	6	1	1	0	0	11
	Other Industry	0	0	0	1	5	6	6	7	4	1	0	30
	Sub-total: Heavy Industries	0	1	2	3	18	13	27	24	13	3	0	104
Services	Banking and Finance	0	0	0	0	1	1	1	2	0	1	0	6
	Construction and Real Estate	0	0	1	0	2	0	3	7	2	1	0	16
	Transport, Post, Telecommunication	0	0	0	0	1	1	1	2	0	0	0	5
	Other Services	0	0	1	0	0	2	0	0	0	1	0	4
Total		2	2	8	9	38	47	50	50	28	13	1	248

(2) Total Investment Capital
Unit: million US$

Sector		1988	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999 (1-8)	Total
Agriculture, Forestry Fishery		0	0	0	10	0	0	0	1	0	0	0	10
Mining		0	0	0	74	0	5	0	3	13	29	0	123
Industry	Food and Food Processing	0	0	4	0	1	33	2	19	9	2	0	69
	Leather Products	4	0	0	1	17	115	8	2	5	1	0	153
	Textiles and Garments	0	0	2	39	30	55	326	37	208	5	0	703
	Wood Produts	0	1	0	0	0	6	0	0	6	0	0	13
	Sub-total: Light Industries	4	1	6	41	48	209	336	57	228	8	0	1071
	Cement, Glass & Non-metal Products	0	0	0	0	17	1	11	18	120	0	0	168
	Chemical Industry	0	0	0	0	16	1	18	45	13	0	0	93
	Electric, Electronic Products	0	0	0	7	187	78	67	60	39	0	0	439
	Machinery	0	0	72	0	36	2	0	100	9	0	0	218
	Metal Products	0	0	0	4	9	56	79	8	3	0	0	160
	Other Industry	0	0	0	1	10	11	13	9	61	1	0	105
	Sub-total: Heavy Industries	0	0	72	13	275	150	188	241	244	1	0	1183
Services	Banking and Finance	0	0	0	0	20	15	15	15	0	15	0	80
	Construction and Real Estate	0	0	1	0	182	0	103	478	68	2	0	835
	Transport, Post, Telecommunication	0	0	0	0	1	1	2	42	0	0	0	46
	Other Services	0	0	0	0	0	1	0	0	0	0	0	2
Total		4	1	79	137	526	381	644	836	554	54	0	3217

Source: VCCI (1999)

Table 14
Trade Structure between Vietnam and South Korea 1989-1998
Unit: % of total export/import value
(1) Vietnam's Main Export Items to South Korea

HS	Heading	1991	1992	1993	1994	1995	1996	1997	1998
3	Fish, crustaceans & aquatic invertebrates	5.9	7.3	7.5	11.9	7.1	5.0	7.1	5.9
7	Edible vegetables & certain roots & tubers	0.0	0.0	0.0	0.0	3.2	5.0	7.3	4.3
8	Edible fruit & nuts; citrus fruit or melon peel	12.2	1.1	0.4	0.5	0.1	0.2	0.2	0.0
9	Coffee,tea, mate & spices	3.1	3.7	3.1	8.3	18.2	4.4	4.8	13.7
12	Oil seeds etc.; misc grain, seed, fruit, plant etc.	0.8	3.4	3.1	1.1	1.7	2.7	2.1	1.3
17	Sugars and sugar confectionary	0.0	0.6	7.1	0.9	0.0	0.0	0.5	0.0
27	Mineral fuel, oil etc.; bitumen subst; mineral wax	29.9	28.1	21.8	6.3	4.8	14.2	8.3	15.5
40	Rubber and articles thereof	1.1	1.9	2.0	4.4	3.4	1.7	1.4	1.5
42	Leather art; saddlery etc.; handbags etc.; gut art	0.0	0.3	0.6	5.0	6.9	7.0	5.9	5.2
44	Wood and articles of wood; wood charcoal	9.9	4.6	2.8	4.6	3.0	2.8	1.5	1.0
46	Mfr of straw, esparto etc.l basketware & wickerwrk	3.5	6.7	3.4	1.9	3.0	2.4	3.7	2.0
50	Silk, including yarns and woven fabric thereof	2.9	2.8	3.1	1.1	0.4	0.6	0.7	0.3
52	Cotton, including yarn and woven fabric thereof	7.2	0.9	3.0	8.9	7.5	8.0	6.6	8.3
55	Manmade staple fibers, incl yarns & woven fabric	1.6	4.2	12.5	13.0	8.0	6.3	4.0	5.5
61	Apparel articles and accessories, knit or crochet	0.8	6.7	5.7	6.3	3.4	1.7	1.8	1.1
62	Apparel articles and accessories, not knit etc.	0.9	6.3	4.8	9.2	7.8	9.5	10.5	5.6
64	Footwear, gaiters etc. and parts thereof	0.3	0.3	0.4	1.0	1.4	4.8	5.3	4.6
72	Iron and steel	8.0	0.0	0.0	0.9	0.2	0.0	0.1	0.2
80	Tin and articles thereof	6.2	6.7	5.6	1.3	0.3	0.0	0.0	0.0
85	Electric machinery etc.; sound equip; TV equip; pts	0.0	0.8	1.1	1.3	4.1	10.9	13.3	8.7

(2) Vietnam's Main Import Items from South Korea

HS	Heading	1991	1992	1993	1994	1995	1996	1997	1998
27	Mineral fuel, oil etc.; bitumen subst; mineral wax	9.3	8.6	14.3	7.0	4.0	2.3	3.5	2.4
29	Organic chemicals	4.1	3.0	2.2	2.1	1.5	1.4	1.4	1.2
31	Fertilizers	20.2	9.7	3.2	3.9	1.6	0.9	1.4	2.8
39	Plastics and articles thereof	4.3	7.3	6.3	7.8	7.9	8.1	10.3	9.4
41	Raw hides and skins (no furskins) and leather	0.0	0.2	0.4	1.2	2.1	3.0	3.5	4.0
48	Paper & paperboard & articles (incl papr pulp artl)	0.5	0.9	1.2	1.2	1.9	1.4	2.1	2.7
52	Cotton, including yarn and woven fabric thereof	1.7	2.7	1.5	2.1	2.4	2.1	2.5	2.3
54	Manmade filaments, including yarns & woven fabrics	10.2	9.1	9.1	8.0	8.9	9.7	8.4	8.4
55	Manmade staple fibers, incl yarns & woven fabrics	10.1	7.4	4.8	5.0	4.5	3.0	3.1	2.5
56	Wadding, felt etc.; sp yarn; twine, ropes etc.	2.0	2.1	1.2	1.2	1.3	2.0	2.1	2.5
58	Spec wov fabrics; tufted fab; lace; tapestries etc.	0.9	1.7	2.0	1.6	1.9	2.2	2.5	1.7
59	Impregnated etc text fabrics; tex art for industry	0.7	2.7	3.9	3.6	4.2	5.2	6.1	6.2
60	Knitted or crocheted fabrics	1.2	1.9	2.5	2.4	2.8	3.3	3.2	3.0
64	Footwear, gaiters etc. and parts thereof	0.0	0.1	0.4	1.0	1.6	2.6	2.4	3.2
72	Iron and steel	3.6	7.0	7.4	10.3	4.8	5.3	3.8	5.4
73	Articles of iron and steel	0.9	1.7	3.3	2.3	3.2	1.5	7.1	2.1
76	Aluminum and articles thereof	0.6	3.7	1.9	0.8	1.8	0.9	1.4	1.5
84	Nuclear reactors, boilers, machinery etc.; parts	6.0	8.2	6.5	9.0	10.7	9.1	8.6	8.2
85	Electric machinery etc; sound equip; TV equip; pts	5.8	11.5	12.3	11.4	11.1	11.5	8.9	8.4
87	Vehicles, except railway or tramway, and parts etc.	2.1	1.9	6.0	6.3	10.0	10.2	4.9	5.7

Source: Korea Customs Service, "Statistical Yearbool of Foreign Trade", various issues

Table 15
Structure of Japan's FDI by Sector and Year of License Issuance
(1) Number of Projects

		1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999 (1-8)	Total
Agriculture, Forestry Fishery		0	0	0	0	0	0	1	2	3	0	1	7
Mining		0	0	1	3	0	1	1	2	0	0	0	8
Industry	Food and Food Processing	1	0	2	2	3	4	6	7	1	1	0	27
	Leather Products	0	0	0	0	0	1	0	0	0	0	0	1
	Textiles and Garments	0	1	0	0	3	5	7	10	3	0	0	29
	Wood Produts	0	0	1	0	2	1	0	0	0	0	0	4
	Sub-total: Light Industries	1	1	3	2	8	11	13	17	4	1	0	61
	Cement, Glass & Non-metal Products	0	0	0	0	1	0	4	7	1	0	0	13
	Chemical Industry	0	1	0	2	1	1	7	3	9	1	0	25
	Electric, Electronic Products	1	0	0	0	0	3	7	6	7	1	1	26
	Machinery	1	2	1	0	0	3	10	11	6	4	1	39
	Metal Products	0	0	0	0	1	4	6	6	3	1	0	21
	Other Industry	0	0	2	0	3	1	7	4	5	2	0	24
	Sub-total: Heavy Industries	2	3	3	2	6	12	41	37	31	9	2	148
Services	Banking and Finance	0	0	0	0	0	0	0	2	2	0	0	4
	Construction and Real Estate	1	0	2	1	4	6	8	1	6	0	0	29
	Transport, Post, Telecommunication	1	0	0	0	0	3	2	4	5	0	0	15
	Other Services	0	2	2	1	0	1	5	5	8	2	2	28
Total		5	6	11	9	18	34	71	70	59	12	5	300

(2) Total Investment Capital
Unit: million US$

Sector		1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999 (1-8)	Total
Agriculture, Forestry Fishery		0	0	0	0	0	0	14	4	4	0	1	24
Mining		0	0	2	121	0	55	4	30	0	0	0	213
Industry	Food and Food Processing	1	0	4	10	6	8	17	23	5	4	0	77
	Leather Products	0	0	0	0	0	2	0	0	0	0	0	2
	Textiles and Garments	0	1	0	0	3	10	20	23	12	0	0	68
	Wood Produts	0	0	2	0	7	3	0	0	0	0	0	12
	Sub-total: Light Industries	1	1	6	10	16	23	38	45	17	4	0	159
	Cement, Glass & Non-metal Products	0	0	0	0	5	0	480	156	2	0	0	643
	Chemical Industry	0	1	0	4	2	6	181	11	164	0	0	371
	Electric, Electronic Products	5	0	0	0	0	19	310	95	87	3	6	524
	Machinery	0	1	4	0	0	54	206	293	30	84	4	675
	Metal Products	0	0	0	0	2	78	30	38	16	1	0	166
	Other Industry	0	0	0	0	3	5	33	12	9	30	0	93
	Sub-total: Heavy Industries	6	1	4	4	12	162	1240	606	307	119	9	2471
Services	Banking and Finance	0	0	0	0	0	0	0	30	16	0	0	46
	Construction and Real Estate	70	0	8	18	89	348	90	20	146	0	0	789
	Transport, Post, Telecommunication	0	0	0	0	0	15	10	23	268	0	0	316
	Other Services	0	1	0	0	0	2	7	19	13	7	1	50
Total		76	3	21	154	116	605	1402	778	772	129	11	4067

Source: VCCI (1999)

Table 16
Trade Structure between Vietnam and Japan 1989-1998
Unit: % of total export/import value
(1) Vietnam's Main Export Items to Japan

HS Heading	1991	1992	1993	1994	1995	1996	1997	1998
3 Fish, crustaceans & aquatic invertebrates	18.8	18.1	21.2	23.2	19.5	17.1	17.5	19.3
9 Coffee, tea, mate & spices	0.5	0.7	0.9	1.9	3.1	1.5	1.4	1.9
16 Edible preparations of meat, fish, crustaceans etc.	1.5	1.8	1.3	1.3	1.8	2.0	2.3	2.4
27 Mineral fuel, oil etc.; bitumen subst; mineral wax	64.3	62.2	51.8	42.8	38.7	35.0	30.8	21.1
42 Leather art; saddlery etc; handbags etc; gut art	0.1	0.2	0.8	1.5	2.6	3.0	2.8	2.7
44 Wood and articles of wood; wood charcoal	3.0	1.7	1.3	1.4	1.8	2.0	1.7	1.7
61 Apparel articles and accessories, knit or crochet	1.7	3.2	5.3	6.4	7.5	7.5	7.1	7.5
62 Apparel articles and accessories, not knit etc.	3.3	7.0	11.2	12.7	13.8	16.5	15.0	16.8
63 Textile art NESOI; needlecraft sets; worn text art	1.1	1.4	2.0	2.6	2.8	2.7	3.0	3.4
64 Footwear, gaiters etc. and parts thereof	0.0	0.1	0.4	0.7	1.0	2.4	3.6	2.2
84 Nuclear reactors, boilers, machinery etc.; parts	0.0	0.0	0.0	0.0	0.1	0.3	1.0	1.6
85 Electric machinery etc.; sound equip; TV equip; pt	0.0	0.1	0.1	0.1	0.3	0.8	2.9	5.4
94 Furniture; bedding etc; lamps NESOI etc; prefab bd	0.1	0.2	0.7	1.6	2.4	3.1	3.8	4.2

(2) Vietnam's Main Import Items from Japan

HS Heading	1991	1992	1993	1994	1995	1996	1997	1998
27 Mineral fuel, oil etc.; bitumen subst; mineral wax	2.2	5.6	3.6	7.0	4.1	2.9	2.8	3.3
29 Organic chemicals	6.9	1.9	2.4	2.5	2.7	2.3	2.4	2.6
38 Miscellaneous chemical products	2.6	1.1	2.4	1.0	1.1	1.3	1.5	1.5
39 Plastics and articles thereof	2.6	2.3	2.3	5.1	4.8	3.5	3.8	4.5
40 Rubber and articles thereof	2.1	0.8	0.5	0.6	0.8	1.0	1.2	1.0
50 Silk, including yarns and woven fabric thereof	0.7	0.5	0.6	1.1	1.0	1.2	1.8	2.4
52 Cotton, including yarn and woven fabric thereof	1.8	0.9	0.9	1.5	1.7	1.9	2.2	1.8
53 Veg tect fib NESOI; veg fib & paper yns & wov fab	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
54 Manmade filaments, including yarns & woven fabric	2.1	2.2	2.4	2.6	2.5	2.6	2.4	2.0
55 Manmade staple fibers, incl yarns & woven fabric	3.4	1.7	2.6	2.8	2.3	2.0	1.8	1.7
56 Wadding, felt etc; sp yarn; twine; ropes etc.	0.5	0.9	1.1	1.6	1.5	1.4	1.2	1.3
58 Spec wov fabrics; tufted fab; lace; tapestries etc.	0.3	0.4	0.4	0.7	0.9	1.2	1.3	1.6
60 Knitted or crocheted fabrics	0.2	0.4	0.3	0.7	1.0	1.1	1.5	1.3
72 Iron and steel	2.9	2.0	4.8	3.6	4.2	3.3	4.7	7.8
73 Articles of iron and steel	4.8	2.3	2.9	5.1	4.6	3.8	3.1	3.4
84 Nuclear reactors, boilers, machinery etc., parts	16.0	11.4	16.5	19.6	21.4	26.9	23.1	22.9
85 Electric machinery etc; sound equip; TV equip, pts	22.4	32.7	10.4	10.4	9.1	9.8	18.7	18.2
87 Vehicles, except railway or tramway, and parts etc	14.9	24.1	31.7	19.7	22.4	20.4	11.8	8.2
89 Ships, boats and floating structure	0.8	0.1	3.5	0.1	0.3	0.0	0.0	0.3
90 Optic, photo etc, medic or surgical instruments etc	1.4	0.7	1.8	3.0	3.3	2.8	2.9	3.1

Source: Ministry of Finance, "Japan Exports and Imports: Country by Commodity",
edited by Customs Bureau, Ministry of Finance, Japan, various issues

At the same time, FDI seems to have increased imports of capital goods, raw materials and intermediate inputs, and this impact seems to have taken place shortly following investment decisions. Fabrics and yarns accounted for a large share particularly in the

early 1990s, which is explained by the need for materials arising from both FDI and subcontracting arrangements. Other important import items include machinery, iron and steel, and plastics. The share of machinery remained steady throughout the 1990s, but the share of industrial material such as iron and steel and plastics increased in the mid-1990s. This may be due to increased investment in heavy industry during the mid-1990s from Taiwan as well as other countries.[21]

South Korea

Tables 13 and **14** show South Korea's investment and trade structure with Vietnam. The increase in South Korea's FDI in labor-intensive industries also quite clearly corresponds with the increased exports of labor-intensive manufactures from Vietnam to South Korea. While the mineral fuel's share of total exports to South Korea decreased, that of apparel, leather items, cotton fabrics and yarns, and footwear increased since the early 1990s. The exports of electric machinery started to increase a few years later during the mid-1990s, which is also explained by increased investment from South Korea in this sector since 1993.

FDI in light industries also seems to have increased imports of materials and capital goods from home. Fabrics and yarns accounted for 20 to 25% of Vietnam's total imports from South Korea, and the share of industrial and electric machinery accounted for another 10 to 20% throughout the 1990s. This seems to reflect, at least partly, the need for materials and capital equipment in textiles, garments, and industries that have dominated South Korea's FDI. The share of industrial materials, such as iron and steel, machinery, and plastics, showed an increasing trend in the mid-1990s, which seems partly due to the increased investment in heavy industries from South Korea and other countries during this period. The decline in the share of vehicles in the late 1990s reflects the introduction of high tariff rates for motor vehicles in 1996 and 1997 to promote FDI in assembly of passenger motor vehicles and to encourage the development of local components suppliers (CIE 1998: 37).

Japan

Tables 15 and **16** show Japan's investment and trade structure with Vietnam. Here, the effect of Japan's FDI on bilateral export structure is hardly observed. The share of mineral fuel decreased substantially since the early 1990s, while the share of light industrial products, particularly apparel, textiles, footwear and furniture, increased quite dramatically throughout the 1990s. However, Japan has not been particularly active in investing in these sectors, as observed from the share of these sectors in both investment

[21] The author's survey of Japanese-affiliated manufacturers in Section 4 shows examples of Japanese firms relying on materials imported from Taiwan.

capital and number of projects. Consequently, such a sharp increase of exports of labor-intensive manufactures does not seem to be a result of FDI from Japan. There are a number of possible explanations. First, as previously mentioned, these are sectors in which many Japanese and other foreign firms have undertaken subcontracting arrangements with Vietnamese firms. Second, substantial exports of labor-intensive manufactures to Japan may have included exports by firms from countries other than Japan, which were investing in Vietnam or have been under subcontracting arrangements with Vietnamese firms, as 'third-country exports'. Though limited evidence concerning this exists, active involvement of firms from countries like Taiwan and South Korea may have contributed to the sharp increase of exports in labor-intensive manufactures[22].

The impact of FDI on imports is also ambiguous. The share of machinery and vehicles accounted for a large share throughout the 1990s, and the share of industrial machinery (HS 84) and electric machinery (HS 85)[23] especially accounted for a much larger share of imports from Japan than in the case of Taiwan or South Korea. This probably reflects the dependence of Vietnamese firms and Japanese investors, as well as investors from other countries, on Japanese capital- and technology-intensive equipment. The increased share of industrial materials such as iron and steel and plastics may also include demands arising from Japanese investments, but the association seems to be weaker than the cases of FDI in light industries from Taiwan and South Korea. The lack of clearly identifiable linkage between Japan's FDI and trade probably has a number of reasons. First, Japan invests in a much wider range of sectors within manufacturing. Second, Japanese firms have more diversified sources of materials and components, as will be shown by the firm surveys in the following sub-section. Third, firms other than Japanese affiliates are also likely to depend on industrial materials imported from Japan.

The vehicles' share of total imports increased until 1993, and it started to decrease after 1994. This is explained by the increase in Japanese auto firms' exports to Vietnam in the early 1990s, the subsequent decision of these firms to invest in Vietnam, and the import substitution effects taking place after the mid-1990s.

The Three Countries Compared

FDI from Taiwan and South Korea was found to have a rather clear and strong impact

[22] Tran and Le (1998) gives an example of a Vietnamese state-owned firm under a business arrangement with a Korean partner to export garments to Japan and other markets.

[23] The table shows that the increase in the share of electric machinery (HS 85) between 1996 and 1997 is quite remarkable. This seems to reflect a large-scale investment project by a Japanese firm. The details will be discussed in Section 4.1.1, with specific data provided in footnote 31.

on increasing Vietnam's exports of products to each respective investing country, and it also increased imports of materials from each country. The FDI-trade linkage was particularly strong in light industries, though contributions of firms under subcontracting arrangements with Vietnamese firms are also likely to be substantial. In other words, Taiwanese and Korean investors were largely found to be shifting labor-intensive processes to Vietnam because of rising labor costs at home.[24] Our analysis suggested that they also seem to have increased exports of labor-intensive manufactures to Japan, a third country. In this regard, FDI from Taiwan and South Korea have contributed to the Vietnamese economy by utilizing abundant labor, increasing exports of manufactured goods, and strengthening Vietnam's linkages in the Asia-Pacific region.

On the other hand, the impact of Japanese investment was not clearly identified from bilateral FDI and trade data. FDI has not substantially increased product exports back to Japan or imports of materials and parts from Japan. This does not necessarily mean that Japanese investment has not had any impact on boosting export-oriented industries in Vietnam, but rather the linkage between FDI and trade may be more complicated than in the cases of Taiwanese or Korean investment. We will examine the impact of Japanese FDI on Vietnam's exports more closely using the results of a survey of firms.

3.3. Evidence from the JETRO Survey of Japanese-Affiliated Manufacturers in Vietnam

In order to analyze the impact of Japanese investment on Vietnam's trade, which was not clearly observed from bilateral trade data, we will examine the results of JETRO's survey of Japanese-affiliated manufacturers in Vietnam.

The survey was conducted by JETRO in November and December 1998, and it focused on subsidiaries of Japanese manufacturing firms in 9 countries in East, Southeast, and South Asia. The survey covered the total of 5,380 firms with which JETRO centers and offices in these regions have dealings. In Vietnam, 79 firms out of the total of 128 surveyed firms responded. The major sectors covered are: clothing and textiles (11 firms), metal products (9 firms), transportation equipment (9 firms), and electric and electronic components (8 firms). In view of the reply ratio of 62%, however, we need to take into account that exporting firms might be over-represented in the survey,

[24] Liu and Riedel (1998), based on a survey of 30 Taiwanese firms in Vietnam, found that Taiwan's investment in Vietnam was largely motivated by rising labor costs at home. They point out: "latecoming Taiwanese investors who are concerned about rising wages in Malaysia and Thailand will likely find Vietnam as an attractive site for their first investments."

because exporting firms, which are generally regarded as faring better than firms targeting the domestic market, are likely to have a higher propensity to reply.

Table 17
Export Orientation of Japanese-Affiliated Manufacturers in Vietnam

	Number of Valid Answers	Number of Export-ing Firms	Export Destination- Multiple Answers (Main Export Destination* in the right of each country/region.)											
			Japan	(Main)	NIEs	(Main)	ASEAN	(Main)	Europe	(Main)	North America	(Main)	Others	(Main)
Food and Agricultural Processing	7	5	5	5	2	0					1	0	1	0
Clothing and Textiles	11	11	11	11										
Chemical and Petrochemical Products	6	4	2	1	1	1	2	1					2	1
Steel	4	2	2	2	2	0	2	0						
Metal Products	9	8	7	6			2	0	1	1				
General Machinery	4	4	4	4	1	0							1	0
Electric Machinery	5	3			1	0	2	1			1	0	2	2
Electric and Electronic Components	8	8	7	4	2	0	5	3	1	1				
Transportation Equipment	9	0												
Components for Transportation Equipment	7	5	4	4	1	1	1	0						
Others	9	8	8	6			1	1	2	1	1	0	1	0
Total	79	58	50	43	10	2	15	6	4	3	3	0	7	3

Source: JETRO (1999)

Note: Main export destination refers to the country/region to which more than 50% of the firm's products are exported.

Impact on Exports

Table 17 shows that exporting firms were prevalent in light industries like clothing and textiles and food and agricultural processing. However, exporting firms are also found in electronics, general machinery, metal products, and parts for transportation equipment, suggesting that exporting firms were not limited to typical light industries, as in the cases of FDI from Taiwan and South Korea. Firms in most of these sectors also had high export ratios.[25] Sectors with low export orientation included transportation equipment and steel.

The same table also shows the main export destinations. Most of the firms in clothing

[25] 49 of the 58 exporting firms replied with their export ratios, and 31 firms replied they exported 100% of their products. The share of firms with 100% export ratios was particularly high in sectors including clothing and textiles (7 out of 11 exporting firms), electric and electronic components (6

and textiles and food and agricultural processing exported mainly to Japan. However, beyond these light industrial sectors, export destinations seem to be more diverse, including NIEs, ASEAN, and Europe. For example, firms in the electric and electronic components industry put much emphasis on ASEAN markets. None of the firms exported mainly to North America, which is perhaps due to the absence of a US-trade agreement.

Table 18
Procurement Behavior of Japanese-Affiliated Manufacturers in Vietnam

	Number of Valid Answers	Source of Raw Materials and Parts - Multiple Answers (Main Source* in the right of each country/region.)							
		Vietnam	(Main)	Japan	(Main)	ASEAN	(Main)	Others	(Main)
Food and Agricultural Processing	7	6	4	5	1	2	0	4	1
Clothing and Textiles	11	1	1	11	9	3	1	3	0
Chemical and Petrochemical Products	6	6	0	6	1	4	2	2	1
Steel	4	3	0	4	2	4	0	3	0
Metal Products	9	4	1	8	8	3	0	1	0
General Machinery	4	3	0	4	4	2	0	0	0
Electric Machinery	5	4	0	3	1	4	2	2	0
Electric and Electronic Components	8	6	0	8	6	5	1	3	0
Transportation Equipment	9	8	0	7	5	6	2	2	1
Components for Transportation Equipment	7	6	0	7	4	5	2	0	0
Others	9	7	3	8	4	6	0	2	0
Total	79	54	9	71	45	44	10	22	3

Source: JETRO (1999)
Note: Main source of raw materials and parts refers to the country/region from which more than 50% of the raw and parts are procured.

Impact on Imports

Table 18 shows that the majority of the surveyed firms depend on Japan as the main source of raw materials and components.

Sectors with a high propensity to procure at least part of their raw materials and components in Vietnam included food and agricultural processing, chemical and petroleum products, transportation equipment and components, electric machinery, and electric and electronic components. They either use resources abundant in Vietnam, or are subject to localization requirements imposed by the Vietnamese authorities.

Although more than half of the firms replied that they imported more than half of their

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out of 8), and metal products (4 out of 8) (JETRO 1999).

raw materials and parts from Japan, the survey also showed that it was common to have multiple sources of inputs. For example, sectors such as electric machinery and components and transportation equipment and components tended to import parts and materials from ASEAN countries. Firms in these sectors have invested actively in other ASEAN countries, and they seem to regard their investment in Vietnam as a part of their regional division of labor.

3.4 Summary of Findings

The main findings of the above analysis in this section can be summarized into the following points.

(1) At the aggregate level, FDI has had limited impact on increasing exports because of the dominance of investments in import substitution industries and the services sector.

(2) In the case of Taiwanese and Korean investment, labor-seeking FDI intended as an export base was found mainly in light industries such as garments and footwear. In the case of Japanese investment, exporting firms were also found in heavy industries.

(3) Labor-seeking FDI increased exports of products from Vietnam to the investing country as well as third countries. Taiwanese and Korean firms tended to export the products back to the home country, but they also seemed to export part of their products to third countries, such as Japan. In the case of Japanese investment, firms in light industries generally depended on the Japanese market, while firms in other industries seemed to have more diversified export destinations.

(4) Both export-oriented and import-substituting FDI increased imports of equipment, machinery, and materials and parts. Taiwanese and Korean firms exhibited a tendency to depend on imports from the home country. Japanese investors also seemed to depend on Japan for most materials and parts, but many seemed to have multiple sources of inputs, including ASEAN countries.

4. The Future Role of FDI in Vietnam

The analysis in the previous section revealed that FDI as a whole has had a rather limited impact on export-oriented industrialization in Vietnam, at least up to the present. In view of numerous problems Vietnam is currently facing in promoting and utilizing FDI, this section discusses the future role of FDI in the Vietnamese economy.

4.1 How Should Vietnam Utilize FDI for its Development Objectives?

Vietnam is currently facing serious constraints to promoting and utilizing FDI. FDI inflows have been rapidly decreasing, and many of the formerly approved projects were dissolved in 1998. Even many of the firms that continue to operate in Vietnam are said to face serious constraints to business.

Despite the numerous problems, effective utilization of FDI will almost certainly be the key to Vietnam's economic development in the future. Vietnam is currently preparing for the trade liberalization schedule under the AFTA framework[26], submits Individual Action Plans (IAPs) for trade and investment liberalization at the APEC meeting every year, and is now applying for the WTO membership. Considering these developments, from now on, Vietnam is expected to face even stronger pressure to liberalize its trade regime. Vietnam, as a latecomer developing country at the early stage of industrialization, will have no other choice than to rely on foreign investment in the course of industrialization.

Then, what should be the focus in Vietnam's FDI promotion in the future? Based on cases of successful exporting FIEs, the author will try to suggest the future direction of Vietnam's FDI strategy.

4.1.1 Cases of Exporting FIEs: Survey of Japanese-Affiliated Manufacturing Firms in Vietnam

Background and the Nature of the Survey

For this survey, the author selected a number of Japanese-affiliated manufacturers in Vietnam with rather successful export-oriented production records. They also had significant contribution to the Vietnamese economy, including increasing exports, creating employment, and transferring technology.

It is true that Japanese investments in manufacturing have mainly concentrated in import substitution industries, and many of these projects have faced difficult situations. In the automobile industry, for example, more than ten of the world's vehicle makers, including major Japanese assemblers, invested in Vietnam in the mid-1990s with the hope for rapid market expansion. However, due to the serious stagnation of the Vietnamese economy following the Asian currency crisis, vehicle sales have kept falling and recorded only 6,882 units in 1999, and 10 out of 11 joint ventures operating in 1999

[26] At the Sixth ASEAN Summit held in Hanoi in 1998, ASEAN countries agreed to accelerate the trade liberalization schedule under AFTA's Common Effective Preferential Tariffs (CEPT) scheme. Under the 'Hanoi Plan of Action', Vietnam has committed itself to maximizing the number of tariff lines with CEPT tariff rates reduced to 0-5% by the year 2003, and to 0% by the year 2006.

incurred losses.[27]

Although the following examples of Japanese investors might be rather exceptional, they should offer significant insights into advantages and problems of the investment environment in Vietnam, and they should be of great help in formulating Vietnam's future FDI promotion strategy.

The following case studies are based on interviews conducted by the author in December 1999. **Table 19** summarizes the main characteristics of the surveyed firms. All of the five interviewed firms were 100% foreign-owned subsidiaries of Japanese firms located in an export- processing zone or industrial zone near Ho Chi Minh City and engaged in manufacturing activities. Four of the firms, namely Firms A, B, C, and D, were exporting all of their products abroad, while Firm E was selling part of their products in the local market. The author will examine how the investment projects have affected Vietnam's exports and imports and look at the benefits and problems of investing in Vietnam, based on the author's interviews with Japanese representatives of the firms.[28]

Reasons for Investing in Vietnam – Low-Cost Labor was the Major Factor

In terms of 'reasons for investing in Vietnam', most of the firms pointed out 'low-cost labor', which seems quite obvious. Although investment decisions during the early to mid-1990s seem to have been affected by the 'investment boom' climate, other important factors raised by the surveyed firms included locational advantage and avoiding country risk. Easy access from suppliers and to markets is obviously important for making export-oriented investment decisions, and the need to avoid excessive concentration of investment in a single country should also be a pressing issue for investing firms. Firm E pointed out 'market potential' as one of the reasons for investing in Vietnam. The firm was exporting part of their products, but it was selling the rest of their products in the local market, still keeping its eyes on the potential for market expansion in the future.

[27] According to the Economist Intelligence Unit (Feb. 18, 2000), auto joint ventures had set up a production capacity of 75,000 units per year. In theory, any one of the 11 auto joint ventures has the capacity to satisfy the market demand in 1999 single-handedly. Only Toyota Motors Vietnam, with the market share of around 32%, was reported to be making profits (Vietnam Investment Review, Feb. 28, 2000).

[28] For Firm D, it was not possible to interview a representative at the factory in Vietnam. The author instead interviewed a manager responsible for the project at the head office in Japan.

Table 19
Characteristics of the Interviewed Firms

	Firm A	Firm B	Firm C	Firm D	Firm E
Main Business Activities	Production of industrial sewing machines & parts	Production of needles for domestic sewing machines	Assembly of parts for computer-related products	Production of small electric motors	Assembly of refrigerators and washing machines
Total Investment Capital *	US$8,436,371	US$2,912,000	US$198,818,719	US$56,484,160	US$75,000,000
Investment Form	100% foreign-owned	100% foreign-owned	100% foreign-owned	100% foreign-owned	100% foreign-owned
Time of Investment	License issued in Mar. 94, started operation in Jan. 95	License issued in Aug. 94, Started operation in Aug. 95	License issued in Sep. 95, Started export in June 96	License issued in Feb. 96, Started operation in 97	License issued in Dec. 95, Started operation in Apr. 97
Location	Export Processing Zone near Ho Chi Minh City	Export Processing Zone near Ho Chi Minh City	Industrial Zone near Ho Chi Minh City	Industrial Zone near Ho Chi Minh City	Industrial Zone near Ho Chi Minh City
Number of Employees	367 (7Japanese and 360 Vietnamese)	190 (2 Japanese and 188 Vietnamese)	2702 (28 Japanese and 2675 Vietnamese including 8 managers, 37 supservisors and 284 engineers)	about 4000 (20 Japanese, the rest are local staff members.)	345 (14 Japanese and 331Vietnamese including 6 managers)
Reasons for Investing in Vietnam	Top-down decision made by management during the 'investment boom' period.	Similarity of culture (compared to other options including India); Low-cost labor.	Avoiding concentration of production sites in Thailand/Philippines; Locational advantage (access to parts suppliers and assembly plants).	Low-cost and disciplined labor; Locational advantage; Avoiding excessive concentration of production sites in China.	Investment boom' climate; Market potential; Low-cost labor; Similarity of culture.
Source of Parts and Materials	100% imported from Japan and Taiwan	100% imported from Japan	100% imported from Japan and Singapore	Materials are mostly imported from Taiwan, Malaysia, etc. Key parts are also imported from Taiwan, but other parts are made in-house using imported materials.	Localization ratio was 60-65%. Parts are produced in-house or bought from Japanese and Taiwanese affiliates as well as local private firms.
Markets	100% exported (worldwide through sales headquarters in Singapore)	100% exported to Japan (partly re-exported to Southeast Asia)	100% exported (45% to the Philippines, 45% to Thailand, 10% to Japan)	100% exported (worldwide, including Europe, Australia, Asia)	Washing machines: 20% sold in local market, 80% exported (worldwide) Refrigerators: 100% sold in local market
Assessment of Vietnam's Investment Climate	Labor management required substantial training/education; Unclear rules and lack of enforcement a major problem; Lack of local supporting industries limits linkages; Large potential for skill-intensive activities.	Problems including the lack of clear legal and regulatory framework, labor management (difficult because of limited supervisory staff), and contraction of demand due to the Asian currency crisis.	Low-cost and high-quality labor a major advantage; Received preferential treatment by local authorities because of substantial contributions to the Vietnamese economy (large export volume and substantial high-tech component).	Low-cost labor a major advantage; Large potential for skill-intensive activities.	Numerous problems including troubles in customs clearance of imported machinery and materials, foreign exchange regulations, localization requirements, competition with illegal imports, and stagnation of local demands.

Source: Based on the author's interviews in December 1999.
Note: Total investment capital figures based on VCCI (1999), except for Firm A for which the database failed to provide the data. Firm A's investment amount was obtained at the interview.

Impact of Investment on Export – Diversified Destinations

The five firms' export activities are summarized as follows.

- Firm A exported industrial sewing machines and its parts to various worldwide destinations through its regional sales headquarters in Singapore.
- Firm B exported needles used in sewing machines to Japan.
- Firm C exported components for computer-related products mainly to its subsidiaries in the Philippines and Thailand for final assembly.
- Firm D exported small electric motors mainly to Europe, Australia and Asia.
- Firm E exported washing machines to worldwide destinations.

The first obvious observation is that the export destinations were widely dispersed, even more than suggested by the JETRO survey discussed in Section 3. Of the five firms, only Firm B exported products mainly to Japan, and even this firm re-exported some of its products to other countries, including Southeast Asia. Having dispersed export destinations has helped the firms avoid the impact of the Asian currency crisis and the recent stagnation of the Japanese economy, which seems to be an important factor behind their success. In addition, Firm A re-exported its products from the regional sales headquarters in Singapore, and such actions seem to be the case especially for large multinationals. The surveyed firms generally used the production base in Vietnam in the context of the firm's regional or global division of labor, rather than as a destination for simply shifting production sites from the home country, which seemed to be the case for much of the investment from Taiwan and South Korea.

The second observation is that, although the products produced by the exporting firms differed widely in terms of industrial sectors and the level of technology involved, they all had one common feature that they specifically located labor-intensive *processes* in Vietnam. For example, although Firm C was producing high-technology products,[29] production processes in the factory in Vietnam were highly labor-intensive – assembly of a large number of very small components requiring a high degree of precision. A representative of the firm said that even those processes operated by machines in Japan are left to manual operations in Vietnam, in order to take advantage of low-cost labor. Most of the other interviewed firms also pointed out low-cost and disciplined labor force as Vietnam's major advantages, and they said the Vietnamese workers' dexterity of fingers and good eyesight make them particularly suited for manual operations requiring precision.

This also suggests the difficulties of drawing conclusions from trade and FDI data

[29] As a high technology project, the firm is able to obtain special privileges from Vietnamese authorities.

because the commodity or industrial classification used for statistical data does not reveal much about the factor intensity of differentiated products or production processes. As the results of the survey show, FDI in sectors other than typical labor-intensive industries – such as metal products or machinery – might include substantial 'labor-seeking FDI' that are in fact intended as an export base.

Third, for a small country like Vietnam, the impact that a single investment project might have on a bilateral trade structure could be strikingly large. Firm C's export performance has been widely regarded as one of the most successful among foreign investors in Vietnam, and it has radically altered the structure of Vietnam's exports to Thailand, one of the firm's main export destinations.[30] It also significantly affected the structure of Vietnam's imports from Japan.[31]

Even admitting that the export records of Firm C were quite exceptional, Firms A, B, C, and D exported all of their products, which should be an important contribution to the Vietnamese economy.

Impact of Investment on Imports – Substantial Need for Imported Inputs

The survey found investment had substantial impact on imports. In the first place, the firms mostly imported machinery and equipment for the factory from Japan. In many cases, they had brought machines and equipment that had been used and had become obsolete in Japan. They do not use high technology but require plenty of labor, so they are rather suited to Vietnam's environment.[32]

The surveyed firms also imported most raw materials and intermediate inputs, except for Firm E which had been making tremendous efforts to raise the local contents ratio, largely prompted by the localization requirement imposed by Vietnamese authorities. Their localization ratio, as of December 1999, was around 60 to 65%; initially it had been around 40 to 45%.

While export destinations were widely dispersed, the source of imported parts and

[30] The exports of electrical machinery and equipment (HS 85) from Vietnam to Thailand increased from US$ 10 million in 1996 to US$102 million in 1997. This roughly corresponds with the firm's export record: the firm's export turnover of US$46.9 million in 1996 and US$279.3 million in 1997 (Vietnam Economic News Mar. 8, 1999), of which around 45% was destined to Thailand. In effect, the total exports from Vietnam to Thailand increased from US$65 million in 1996 to US$ 140 million in 1997 (Thai Customs Department, various years) – a single investment project from Japan more than doubled Vietnam's total exports to Thailand, a third country, in a year.

[31] The sharp increase in the electric machinery (HS 85)'s share of Vietnam's imports from Japan going from 9.8% in 1996 to 18.7% in 1997 (Table 16, discussed in Section 3.2) was due to the increased imports of electronic integrated circuits (IC) and microassemblies, from US$ 19 million in 1996 to US$ 94 million yen in 1997 (Ministry of Finance, various years).

[32] Firm C had introduced some modern and high technology equipment, but overall it relied on labor-intensive processes.

materials seemed to be much more concentrated. They came mostly from Japan and some came from East Asian NIEs, such as Singapore and Taiwan. While Firm C said that the necessary parts and materials simply did not exist in Vietnam, Firm A said their localization attempt failed because the quality of local materials was too low. A representative of Firm A added that the local Vietnamese firms perceived the concept of 'quality' very differently from them, and they gave up the hope that technological instruction of local firms might help them reach the quality standard required. Firm B said that steel used by them was specifically made by a Japanese company for the firm, and they could not obtain it anywhere else. Overall, the Japanese investors seemed uncompromising regarding the quality of their products as well as inputs, which, together with the underdeveloped state of the local supporting industries, probably reinforced their tendency to import the necessary materials and components back from home or other more developed economies in the region.

Future Direction – Potential for Skill-Intensive Processes

While all of the interviewed firms were relatively successful among Japanese investors in Vietnam, the following firms were particularly hopeful of future expansion of their investment projects.

- For Firm A, China was definitely the most important investment destination because of the huge market and large potential for the clothing industry, and the firm had several factories in China for mass production of low-end products. A representative of the subsidiary in Vietnam expressed his view that Vietnam is suited for producing high-quality sewing machines in small quantities in the future. The representative looks forward to this because of low-cost labor with a high potential for producing high-quality products, given decent training and proper incentives.
- Firm C has successfully transferred some technological development functions to local engineers.
- While Firm D had production sites in Taiwan, China, Malaysia, and Vietnam, key parts, requiring the highest quality, were produced in Taiwan. A manager in charge of the project in Vietnam believes the high capabilities of Vietnamese labor might enable them to relocate these production processes to Vietnam in the long run.

Whereas Vietnam has attracted investment in relatively simple labor-intensive activities, the interviewed firms generally agreed on the potential of Vietnamese workers to perform skill-intensive activities, provided that they receive proper training and incentives. Firm C also gave high remarks to the quality of Vietnamese engineers. This suggests that Vietnam needs to take maximum advantage of its labor – not simply because of the low cost but because of the high potential for skill-intensive activities.

4.1.2 Focal Aspects for Vietnam's FDI Promotion in the Future

The above case studies of exporting FIEs suggest that the following aspects of FDI should be of prime importance for Vietnam in the future.

The first is the focus on export-oriented FDI, and particularly projects with diversified export destinations. Although Vietnam started to promote FDI for development of key industries in the mid-1990s, the bulk of FDI in heavy industry and services faced difficulties due to the stagnation of the Vietnamese economy. Taking account of the limited prospects for rapid growth of the Vietnamese market in the near future, the future focus will necessarily be on export-oriented FDI. It will also be an important means for Vietnam to earn foreign exchange and promote the learning process to improve product quality and competitiveness.

The second is the emphasis on the skill-intensive component of labor-intensive industries, which requires substantial improvement in the quality of labor. In part, the surge of FDI into Vietnam has developed because of the rising labor costs in other Asian countries; and the abundant low-cost labor in Vietnam has been a major attraction for investors. However, the strategy to rely solely on low-cost labor is risky because such investment is footloose, and investors are likely to shift their production sites to other destinations as their wages become higher compared to other countries. This is especially likely if the host country lacks other factors that are particularly attractive to investors, such as a huge market potential, as in the case of China, or a solid domestic industrial base, which would offer the advantage of agglomeration for foreign investors. As discussed previously, the interviewed firms generally agreed on the high potential of Vietnamese workers in skill-intensive activities, provided that they receive decent training and incentives.

This aspect is particularly important from the regional perspective, which deserves more attention. First, since investors' interest in Vietnam seems to have eroded because of other more important investment destinations in the region, Vietnam needs to strengthen its unique advantage over others, i.e., low-cost labor suited to skill-intensive activities. Among the firms interviewed by the author, Firms A said that China was undoubtedly the most important investment destination because of the huge market potential, but Vietnam was still attractive for locating skill-intensive processes. Second, the emphasis on skill-intensive processes seems to be the most plausible way for Vietnam to take part in the division of labor in East and Southeast Asia, which is emerging in some of the most dynamic industries. This is especially crucial because Vietnam's involvement in complementation and networking of industrial activities in the ASEAN

region so far has been quite limited.[33]

Third, the accumulation of manufacturing investment in the southeastern region of the country – specifically, Ho Chi Minh City and neighboring provinces including Dong Nai – deserves more attention. The area has several export-processing zones and industrial zones that continue to attract foreign investors in manufacturing. In fact, statistics show that FDI into Ho Chi Minh City increased slightly from 1997 to 1998 in terms of the number of licensed projects; though it decreased in the amount of investment capital.[34] Since agglomeration provides substantial advantages for manufacturing firms, this region deserves special focus in FDI promotion and development of local firms.

4.1.3 Unresolved Problems in Vietnam's Investment Environment

Despite large potential as an investment destination for labor-intensive manufacturing processes as mentioned above, Vietnam's investment climate still has numerous problems. The Asian currency crisis has undoubtedly been an important factor behind a sharp fall in FDI inflows, but it is now widely agreed that the crisis was not the only reason, or even the most important reason. In fact, while FDI inflows into Thailand actually increased during and after the crisis, FDI into Vietnam is still falling sharply in the year 2000.[35] It has become clear that domestic structural factors are far more important, and they summarized as follows.

The first factor is the stagnation of the Vietnamese economy, which is particularly serious for firms targeting local markets and the services sector. During the so-called 'investment boom' period, foreign investors flooded into Vietnam, because they did not want to miss the market opportunities expected from rapid economic growth. Many of them have withdrawn from Vietnam, and many others are facing a crisis of survival.

Second, frequent changes in policies and regulations, inconsistencies, and insufficient enforcement make the investment environment uncertain and become a constraint to business activities of foreign firms.

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[33] ASEAN has an industrial cooperation program to promote the sharing of industrial activities between ASEAN-based companies, called the ASEAN Industrial Cooperation (AICO) Scheme. As of April 1998, 14 companies, including 8 Japanese, had applied for the scheme, but none of the applications involved Vietnam (ASEAN Secretariat, 1998).

[34] The number of licensed projects in Ho Chi Minh City increased from 90 in 1997 to 93 in 1998, whereas the investment capital amount decreased from US$ 1,174 million to US$ 906 million (Statistical Office of Ho Chi Minh City 1998).

[35] FDI inflows into Thailand increased from US$ 2,336 million in 1996 to US$3,733 million in 1997, and US$6,969 million in 1998 (UNCTAD 1999). In Vietnam, only 21 FDI projects, with a total registered capital of US$58.9 million, were licensed in the first two months of 2000 (Saigon Times Daily, Mar.1 2000), while the figures for the same period in 1999 were 34 projects and US$320.6 million (VCCI 1999).

Third, incentives offered to foreign firms are still not sufficient, especially compared to Vietnam's Asian neighbors. Vietnam has the so-called 'dual-pricing system', which applies higher prices for foreign firms than for the Vietnamese for a wide range of services. In July 1999, the government issued a decree to reduce prices for public utilities, including electricity and telephone, but it fell far short of providing equal treatment between domestic and foreign firms.

Fourth, the lack of competitive domestic supporting industries is problematic both for investors and for Vietnam. This is particularly a pressing issue for industries upon which the government imposes localization requirements, such as electronic products and automobiles, as we already observed from the case of Firm E. For Vietnam as a host country, the lack of local supporting industries substantially limits FDI's spillover effect on its economy through technology transfer and development of local linkages. Vietnam's value-added gains from simple processing investment remain quite limited.

Fifth, there is the issue of training the labor force. Although most of the firms interviewed by the author give high remarks to the quality of the Vietnamese labor force, it does not mean that they were productive as factory workers right from the beginning. Most of the firms added that it required intensive training to make them suitable for factory operations; some examples of the training programs are as follows:

- Firm A: In the start-up phase, several staff members from Japan went to Vietnam to intensively train the Vietnamese staff. The firm adopted measures such as performance-based promotion and bonuses to increase the incentive of the workers. It eventually reduced the number of Japanese staff members while transferring various responsibilities to Vietnamese staff members.
- Firm D: The firm recruited approximately 20 Vietnamese staff members as would-be managers, and the firm sent them to Japan for training and for leaning the Japanese language. In the firm, they are responsible for leading other Vietnamese staff members, and the Japanese staff members give instructions only through these leaders.
- Firm E: The firm recruited several Vietnamese would-be managers and took them to Japan for a training program, teaching both general and technical knowledge. The company also sent them to a Japanese language school in Ho Chi Minh City.

Like this, relatively large multinationals are able to cope with training and labor issues with their own programs and efforts. However, such was not the case for small- or medium-scale investors. Firm B had only a few Japanese staff members, and it was having difficulties training local employees, which inevitably focused on on-the-job programs.

Many other problems exist, such as weak infrastructure and problems in coordination with joint venture partners. Recently, however, investors seem to be cautious enough to choose investment types that enable them to avoid these problems beforehand. For example, investors may choose to locate in export processing or industrial zones that have their own provisions of infrastructure, or they may set up wholly foreign-owned subsidiaries instead of joint ventures.

4.2 Policy Implications

In order to maximize the use of FDI in the direction described above, Vietnam needs to make substantial adjustments to its policies to improve the investment climate. In this regard, it will have to consider ways to make the best use of multilateral, regional and bilateral frameworks for economic cooperation, each of which will have different roles to play. Recommended policies and actions, as well as the potential contributions of developed countries and multilateral and regional institutions, include the following.

First and foremost, Vietnam needs to offer a long-term and consistent policy environment for foreign investors without frequent or piecemeal changes, and it needs to make efforts to eliminate discriminatory treatment and measures against foreign firms. Particularly in the recent years, the lack of clear commitment to further reform and liberalize the economy has made foreign businesses increasingly skeptical about the future prospects for reform and reluctant to invest in Vietnam.[36] While Vietnam's recent attempts to improve its investment climate have been largely in the form of piecemeal adjustments, foreign investors seek for more fundamental and long-term commitments to liberalize the economy and to offer equal treatment for foreign firms.

Regarding Vietnam's policy environment, the issue of consistency with policies in other related areas, e.g., trade policies, is also important. Due to prolonged protection in the form of tariffs and non-tariff barriers, a substantial proportion of FDI has flowed into import substitution industries despite the limited size of the market.[37] In addition, frequent changes in tariffs have been regarded as a serious problem for foreign investors. Vietnam should ensure a consistent and stable policy environment by adjusting policies in areas related to FDI.

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[36] This is typically observed in Vietnam's hesitation to sign the trade agreement with the US, which reflects the country's unwillingness to liberalize the economy in fear of the adverse impact on domestic enterprises (Nihon Keizai Shinbun, Mar. 6 1999). Especially as China has recently shown clear commitment to accelerate reforms in preparation for its membership in the WTO, foreign investors will likely accelerate even further their shift away from Vietnam in the near future.

[37] CIE (1998: 131-2) estimated the distribution of FDI by effective rates of protection (ERP), and points out that the majority of FDI has flown into sectors with high ERP; around 65% of FDI has been in sectors with ERPs above 60%.

Second, Vietnam should make efforts to develop clear and comprehensive legal and regulatory framework. Currently, the lack of legal infrastructure as well as insufficient enforcement have resulted in 'rule of people' instead of 'rule of law', and this has imposed significant costs on foreign businesses.

Third, in order to maximize the use of the country's rich human resources and to enable the country to attract projects in more skill-intensive and high-value-added activities, Vietnam should improve the quality of its labor force though education and vocational training.

Fourth, Vietnam should also make long-term efforts to develop competitive local supporting industries. Recently, Vietnamese authorities seem to be well aware of the importance of small and medium enterprises (SMEs) for their economy. They have also undertaken various studies on the situation SMEs, with an attempt to formulate policies to promote development of SMEs.[38]

In order to support Vietnam's efforts, bilateral aid and assistance from multilateral financial institutions will play an important role, especially in areas requiring large financial resources such as developing infrastructure.[39] They will also have roles to play in areas requiring skilled experts and experience, such as development of a legal and regulatory framework, vocational training and educational programs, and support for SMEs, and numerous on-going initiatives continue in these areas.[40]

Regarding APEC, Vietnam has not yet become substantially involved in APEC's activities since it became a member in 1998, and information on specific APEC activities has not been disseminated thoroughly to relevant organizations or businesses in Vietnam.[41] What opportunities would APEC offer Vietnam?

APEC includes many of Vietnam's most important investment and trade partners. The analysis in this study has shown that FDI from some Asian countries has focused particularly on industrial sectors; whereas countries in other regions, including Europe,

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[38] An example is the research project undertaken by MPI and UNIDO (1999).

[39] Japan, the World Bank and the Asian Development Bank are the top donors in Vietnam. One of the priority areas for ODA loans has been the development of infrastructure, including electricity, transport and port facilities.

[40] With financial support from the Japanese government, the Vietnamese government has developed the Private Sector Action Program, which includes schemes for financial and technological support for SMEs (World Bank 1999). The Japanese government has also announced it will send legal experts to Vietnam to develop the overall legal framework through the Japan International Cooperation Agency (JICA)'s assistance program (Sankei Shimbun, Jan. 14, 2000).

[41] Based on the author's interview with Ms. Tran Thu Hang, APEC-ASEM Division, Multilateral Trade Policy Department, Ministry of Trade, Hanoi on December 14, 1999. She noted that due to the lack of financial resources Vietnam's involvement in APEC activities had been limited to participation in Ministerial Meetings, Senior Officials Meetings, and a number of meetings organized by various Working Groups and the Committee on Trade and Investment (CTI).

have invested largely in services and mining. Especially, FDI from countries like Taiwan, South Korea, and Japan was found to significantly contribute to the Vietnamese economy, including export promotion, employment generation, and technology transfer. In this regard, it will be extremely beneficial for Vietnam's development objectives to further promote FDI from the APEC region. Vietnam should benefit substantially from APEC's investment promotion initiatives, especially the ECOTECH components.

In fact, Vietnam's interests in APEC activities seem to lie mainly in the ECOTECH aspects. At the APEC Ministerial Meeting in Auckland in 1999, Vietnam called for greater efforts from developed country members to boost ECOTECH activities.[42] However, APEC's ECOTECH is based on the principles of mutual respect and calls for voluntary contributions of all the members. This is completely different from one-way transfers of funds based on a donor-recipient relationship, as in the case of bilateral aid. APEC's style of economic and technical cooperation may not be suited for providing financial assistance, but its 'voluntary' nature should have considerable benefits for Vietnam. APEC does not set obligations for its members to comply with trade liberalization, as in the case of AFTA or WTO, nor does it set rigid conditionalities that the countries need to accept in exchange for financial assistance, as in the case of the IMF or World Bank loans.

Vietnam will benefit greatly from ECOTECH in the field of investment promotion and utilization, particularly in the long run. Vietnam would benefit greatly from projects organized by the Committee on Trade and Investment (CTI) for improving the investment climate in the APEC region. For example, CTI has organized training programs on strategies for investment promotion and FDI policy administration and adjustment.[43] Vietnam should also take advantage of projects for human resources development, such as vocational training programs, and development of SMEs. Vietnam's active involvement in these activities would expose the country to the experience and latest policy developments of its regional neighbors, which have utilized FDI for economic development objectives with various degrees of success, and Vietnam should have a lot to learn from them. Such an active involvement, combined with the continued endeavor to improve the investment climate and liberalize its investment and trade regime towards the Bogor goal, will help Vietnam recover FDI inflows from the APEC region.

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[42] Saigon Times Daily, Sep. 7, 1999.

[43] Based on "Economic and Technical Cooperation Matrix by Six Priorities" available on the APEC web site (www.apecsec.org.sg).

Conclusions

This paper focused on the impact of FDI on export-oriented industrialization in Vietnam. While FDI in Vietnam as a whole has had a rather limited impact on export-oriented industrialization, investments from a number of important Asian countries were found to have substantial export-promotion effects in certain sectors. FDI from Taiwan and Korea, which mainly shifted labor-intensive processes due to rising labor costs at home, significantly promoted exports of light industrial products back home. On the other hand, FDI from Japan has been more complicated in its effects on exports as well as imports. Exporting firms were found not only in light industries but also in heavy industries. Export destinations and sources of parts and materials were more diverse because many of the investing firms placed production sites in Vietnam in the context of their regional or global network of production and sales. Although East Asian NIEs and Japan had different patterns of FDI-trade linkage, FDI from all three countries had significant contributions to the Vietnamese economy, including export promotion, employment generation, and technology transfer. Compared to investments from other regions that have focused on services or mining, FDI from the APEC region, especially East Asian countries, is likely to benefit the Vietnamese economy and industry.

In view of increasing international pressure for trade liberalization, Vietnam will have to depend on FDI for industrial development. Despite the sharp falls in FDI inflows in recent years, the results of the author's survey of Japanese-affiliated manufacturers showed that Vietnam still seems to have great potential for attracting investment in export-oriented production of labor-intensive products. In the future, Vietnam needs to take advantage of its low-cost and disciplined labor force and to promote investments in skill-intensive and high-value-added activities.

Such an investment promotion strategy requires substantial efforts on Vietnam's part, but international assistance through various channels will also play considerable roles. Over the past two years since Vietnam became an APEC member, it has not fully taken advantage of APEC's activities. A latecomer developing country like Vietnam would benefit substantially from ECOTECH programs for improving its investment climate and promoting FDI from the APEC region.

Lastly, the author would like to note that FDI from East Asian NIEs and Japan has had contributed to Vietnam's interdependence in the Asia-Pacific region in different ways, which is perhaps explained by the difference in the level of economic development and history of investing in the Asian region. This suggests that it would be worthwhile to

conduct further comparative research on FDI from other important APEC members that have a strong presence in Vietnam. Particularly, in view of the emerging economic linkages within the ASEAN region and the progress of initiatives like AFTA, AICO, and ASEAN Investment Area (AIA), Vietnam's trade and investment relations with other members of ASEAN such as Thailand and Malaysia would constitute a possible area for further research.

Appendix FDI Data Used in this Study

(1) Ministry of Planning and Investment (MPI) Data

MPI is chiefly responsible for compiling FDI data in Vietnam. The MPI data cover information on FDI commitments and disbursements, as well as turnover, exports, imports and tax obligations. The MPI data used in this study, covering the period from 1988 to the end of September 1999, were obtained during the author's visit to the ministry in December 1999.

Since the MPI data only provide information on an aggregated basis and are not suited for disaggregated analysis by sector or investing country, the following two sources of data will be used for supplementary purposes.

(2) Database of Licensed Projects Published by the Chamber of Commerce and Industry in Vietnam (VCCI 1999)

This database contains all of the 2,643 investment projects licensed between 1988 and August 1999. The information covered includes project name, investing country, type of investment, main activity, location, date of license issuance, total investment capital, legal capital, duration of the project, and operating status.

In this study, this database was used mainly for disaggregated analysis of licensed projects.

(3) IMF Data (IMF, 1999a, b)

IMF data are based on the MPI data but adjusted by the IMF staff according to data and information from the State Bank of Vietnam and the Ministry of Finance. This adjustment intends to correct the upward bias which is likely to exist in the MPI data caused by the tax incentives enterprises receive for FDI-related activities (IMF 1999a). The data released on the country report include commitment and disbursement figures, some of which are broken down by investing countries and sectors.

In this study, IMF data are used mainly for obtaining disbursement figures.

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