Division for Africa, Least Developed Countries and
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How did star performers in developing countries foster productive capacities and structural economic transformation through linkages between domestic and FDI firms? (Vietnam's experience with policy lessons for Ethiopia)

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Outline of the presentation

I. Key home-take from the presentation
II. Ethiopia and Vietnam (1985-present)
III. Vietnam's unprecedented transformation
IV. Evolution of FDI and domestic firms in Vietnam
V. Key FDI-based policy outcomes
V. Linkages between FDI and domestic firms
VI. Conclusions and policy lessons for Ethiopia

Key messages from the presentation

To maximize the role of FDI and foster linkages:-

- *Policy sequencing matters (comparative advantages, binding constraints & interventions)*
- *Consistent and coherent trade, industrial, and other sectoral policies are key.*
- *Unambiguous and clearly defined policy objectives & targets are critically important.*
- *FDI should be viewed from holistic perspectives (boosting capital formation, economic growth, exports and employment).*
- *Fostering linkages between FDI and domestic firms is not automatic even for dynamic and sophisticated economies such as Vietnam.*
- *Robust, sustained and inclusive growth played vital role in ensuring political stability, retaining greenfield investment and maximizing benefits from FDI.*
- *Pragmatic, forward-looking and *"experimental" policies as well as entrepreneurial State have been key drivers of FDI & export-led strategies in parallel with Import Substitution (IS) strategies.*
- ***More than liberal FDI regimes and incentives, improved aggregate income, enlarged markets, growing middle-class, global and regional integration, and the provision of vital infrastructure played vital role in Vietnam**.*

I. Vietnam and Ethiopia: “Initial conditions”

Pre-1986 Vietnam and pre-1993 Ethiopia:-

- Were among the poorest countries in the world

(Low per capita income, agrarian economy and generalized poverty)

- Had war-ravaged infrastructure and economies;
- Followed “socialist industrialization” model- driven by the State;

(Restricted trade, absence of the private sector or competition)

- Had comparable population size and growth rates
- Vietnam was a divided nation (“communist” North and “capitalist” South;
- Ethiopia was in socioeconomic and political turmoil;

❖ Vietnam’s relative advantage over Ethiopia was only locational- being in dynamic region.

❖ Unlike Ethiopia, Vietnam also had colonial history and political economy.

II. Vietnam’s unprecedented transformation

In less than 35 years (1986*-2020)……

- GDP has increased 19-folds: US$14 billion to US$271 billion
- GDP per capita spiked 14-folds: US$243 to US$3,500
- **Merchandise exports:US$340 million to US$282 billion**
- Imports :US$ 1.34 billion to US$ 262 billion
- **FDI flows increased from: US$ 2.8 billion in 2000* to US$16 billion in 2020**
- **FDI stock US$ 177 billion in 2020**
- Proportion of the poor: 80 % to less than 2%
- Lowest unemployment rates (2-3 % currently)

❖ ***Gradually, the role of trade, FDI and private domestic investment has significantly increased (confirming Export-FDI led strategy.***

…Sectoral shift and socioeconomic transformation (pre-1986-2020)

- The role of agriculture (subsistence) was substantial prior to 1986

(80 % of national income; 44% of GDP and 76% of total labor force)

- Agriculture's share in GDP: 44% to 14.8%; employment: 76% to 36%
- Industry's GDP and employment shares in 2020: 34% and 28%, respectively
- Services sector: 41% of GDP and 35% of employment
- ***Share of manufacturing in total industrial output: from less than 20% to 87%**
- **Annual average growth rate industrial output: 15.2 % (for 34 years).**
- **Access to energy (electricity) including rural areas has reached 100%**

❖ The country's industrial ratio in GDP (a rough measure of industrialization) and production transformation has skyrocketed over the years***).***

III. Evolution of FDI and domestic firms in Vietnam

- Private sector is new in Vietnam (1986: Doi-Moi)
- The legal framework for FDI entry was launched as part of the "renovation" or reform programme;
- It has since been periodically reviewed to accommodate legal, institutional and economic changes in the country

**Accession to the WTO, bilateral (USA, Japan) and regional (ASEAN, EU) agreements were key in reshaping FDI laws and regulations.*

❖ ***With subsequent reforms, the role of FDI and private sector has become substantial***

a) key reforms include “classical and non-classical”….

- Open trade and investment regimes (liberalization)
- Improved trading rights, the tariffication of non-tariff barriers;
- Easing of local content requirements;
- National treatment clauses;
- Establishing Special Economic Zones, EPZs and IZs
- **Designing effective and targeted incentive structures**

- **The provision of infrastructure facilities particularly public utilities**
- **Delegation of FDI management authority to local governments,**
- **Continued dialogue mechanism with FDI home countries**

b)Mega growth poles and SEZs as part of the policy reforms.

With the aim to boost FDI, three regions or areas were identified as mega growth poles

- Hanoi and vicinity (Northern); Ho Chi Minh City (Southern); Red River Delta region (Central)- each region rivaling one another.

Each having

- Export Processing Zones: (exports and related services)
- Economic Zones or Industrial Zones (Industrial production & services)
- High-tech Zones: specialize in technology development, production and distribution

❖***Industrial zones are popular among FDI firms and domestic firms***

❖***In 2018, there were 326 such zones with 249 (76%) operational consisting of***

-7500 domestic projects worth of US$42 billion

-8000 foreign projects with the total value of US$145 billion

c) What is special about Vietnamese SEZs, EPZs or IZs?

- High quality and dependable infrastructure such as electricity, ICT and utilities;
- EPZs were developed by joint ventures between Vietnamese state-owned enterprises (SOEs) and foreign partners;
- Separation of state management functions and business management

(Overall management by State while the Taiwanese partner manage business activities in EPZ including infrastructure leasing price)

- FDI projects in SEZs or EPZs were directed towards the production of goods meant for export or producing import substitution goods
- Gradually IZs created to promote FDI enterprises, seeking to produce goods for both domestic and foreign consumer markets.
- The shift from the EPZ to the IZ model was mainly induced by investor demand, which was no longer fond of purely export-oriented production.
- Targeted incentives for dynamic, competitive and greenfield investors

IV. key FDI-based outcomes or achievements…

- FDI flows and stocks reach unprecedented levels
- Vietnam emerged as competitive & "ideal" location for FDI

-FDI flows reached US$16 billion in 2020 (Registered US$28 billion)

-FDI stock……………..US$177 billion in 2020

- Leading FDI sources: Japan, South Korea, Singapore, Taiwan, Hongkong and mainland China)

- FDI generates

- nearly 30% of the average economic growth of (6.5 %)
- 70 % (US$ 282 billion) exports and 25% of capital formation

- FDI is widely distributed across 19 sectors of which manufacturing and processing account for 65 % of FDI
- Between 2015-2020 annual labour productivity (average) grew by 7% (more than any other major emerging economy

……key policy outcomes…

- Industry, including manufacturing, and construction-based firms account for 53 % total labour force and 62% of national value added)
- SMEs represent 96 percent total capital stock of companies and 47 % of labour force, 36% of national value added
- Investment by domestic private firms has also expanded
- Domestic private firms account for 29% of exports
- SOEs account for about 1% of total exports

…..Vietnam’s distinguishing features in FDI-led industrialization……

More than rules and regulation, key success factors and drivers of FDI in Vietnam include:-

- Sustained peace and political stability
- Robust and inclusive economic growth;
- Improved aggregate income and demand,
- Availability of cheap and highly productive labour force;
- Dynamic sectors and availability of supplies (raw materials)
- Continuously enlarging markets (domestic, regional and international)
- Availability of infrastructure- energy (electricity) , transport and ICTs
- Pragmatism, monitoring, dialogue mechanisms and delegation of authority

V. Linkages between FDI and domestic firms in Vietnam….

- Vietnam views FDI from a holistic perspective (economic growth, trade, employment and linkages or spillovers);
- High-level of linkage is still a challenge but surely developing;
- Local content in production activities in Viet Nam was only 36.3%, compared with 66.3% in China, 57.2% in Thailand, and 42% in Indonesia;
- Vietnamese SMEs perform quite well both in product and process innovation, including in the adoption of automation,
- SMEs play a relevant role in exports, accounting for 88% of exporting enterprises and for about half of export volume.
- 70% of Viet Nam's SME exports comes from foreign-owned firms

…. Forms and extents of linkages vary with the sophistication of production

- **Food, beverages and tobacco industries** constitute integrated value chains;

  - Had a local content as high as 80 per cent during 2015-2019

- **Labour-intensive sectors** (garments and clothing , leather and footwear firms

  - Local content is high in upstream activities in the value chain

  - downstream activities engage in large subcontracting schemes and imports of intermediate inputs such as chemicals;

- **High-skills and High-tech sectors** are the least contributing to linkages between FDI and domestic firms is the high-vale, high-skills and high investment technology sector but it is a high growth sector.

➢ ***The lesson here is that even for dynamic economies such as Vietnam's perfect or full linkages are not a distinct possibility but that has not deterred the country from benefiting from FDI (i.e., generating growth, boosting capital formation, exports and employment opportunities).***

➢ **How and where in the value-chain can a country integrate matters.**

VI. Some concluding remarks….and lessons

Vietnam:

- Implemented export-led strategies in parallel with targeted and managed Import Substitution (IS) strategy.
- Fostered economywide productive capacities including high industrial ratio
- Used appropriate policies to support FDI attraction, promotion and retention
- Provided necessary conditions for the effective decentralization of FDI management;
- Developed dialogue (consultation) mechanisms with existing and potential investors;
- Developed SEZs, EPZs, IZs along mega growth poles for FDI and domestic firms
- Boosted infrastructure (transport, electricity, ICTs)
- Decentralized functions and tasks related to FDI promotion and management to provincial, municipal government authorities and FDI firms
- Pursued effective strategy of managed and beneficial regional and global integration
- Put in place mechanisms for effective and coordinated monitoring and evaluation of progress of projects.

....Lessons for Ethiopia

- *FDI promotion can* be effective only if it is accompanied by appropriate policies which are in synch with the overall development objectives.
- *Coherent and consistent trade*, FDI, infrastructural &industrial policies are critically important to strategically harness comparative advantages.
- *Predictable and stable political, regulatory and macroeconomic environment* is better than heavy financial incentives for attracting efficient FDI & promoting linkages.
- *Delegation of FDI management* leads to better leverage FDI & foster linkages.
- *Government must take the lead* in building infrastructure such as predictable & affordable transport, electricity and other utilities.
- *Robust, sustained and inclusive growth* is vital for improving aggregate national income, demand and supply as key for mobilizing investments.
- *Catalyzing varied sources of growth* (drivers and enablers) in production process is key to foster linkages by ensuring high-local content.