# How to Break Through the Middle-Income Trap in the Growing Vietnamese Economy: The Key Role of Management Skills and Human Resources

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Abstract

This paper considers the development possibility of local Vietnamese firms based on our survey. The Doi Moi policy is well known as the opening-up policy of a remarkably growing Vietnam. Since the second half of the 1990s, Vietnam has emerged as the second best investment destination under the "China +1" scheme, and has experienced high growth rates during the latest big wave. Will this growth continue? The World Bank and the Asian Development Bank point out that in the not-too-distant future, East Asia will be creating a dominant part of the world's wealth and will bring about a historical restoration of Asia, provided the growth of the past decade continues. On the other hand, there is a discussion that some major East Asian countries may be losing speed. This is the so-called "Middle Income Trap." This warning has been raised for China, India, Indonesia and other countries, including Vietnam. We undertook a

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survey related to the management and reform potentiality of human resources of Vietnamese corporations towards overcoming issues in development. Based on our survey, we confirmed that Vietnam's local firms are supporting the national economic development. At the same time, we will count on the potential to continue to do so. The issue remains how such potential would manifest itself.

## Introduction

The Doi Moi policy is well known, even in Japan, as the opening-up policy of a remarkably growing Vietnam. Since the second half of the 1990s, together with the growing interest in China as a prime investment destination, Vietnam has emerged as the second best investment destination under the "China +1" scheme. Entering this century, Vietnam has attracted further interest, to the extent that rising labor costs have been reported alongside the investment boom in Vietnam.

However, it is not only Vietnam that has been continuously growing. East Asia has been growing as a region, through several waves of growth: starting with the newly industrialized economies (NIES) from the second half of the 1960s, followed by the early member nations of the Association of Southeast Asian Nations (ASEAN) in the '80s, China in the '90s, and then the late member nations of ASEAN. During this period, the 1997-98 Asian Currency Crisis, and the 2008-2009 World Financial Crisis erupted. Nevertheless, the East Asian countries did grow and continue to do so, admirably defying all pessimistic predictions following the crises. Vietnam is among the countries that experienced high growth during the latest big wave.

Will this growth continue? Simulation results shown in the reports of international financial institutions such as the World Bank and the Asia Development Bank point out that in the not-too-distant future, East Asia will be creating a significant portion of the world's wealth, and will bring about a historical restoration of Asia, provided the growth of the past decade continues. On the other hand, there is a discussion that some major East Asian countries may be losing speed. This is the so-called "Middle Income Trap." This warning has been raised for China, India, Indonesia and other countries, including Vietnam.

Bearing this in mind, we undertook a survey related to the management and reform potentiality of human resources of Vietnamese corporations towards overcoming issues in development. In this paper, we consider the development possibility of local Vietnamese firms based on our survey, as well as organize our awareness of the problem leading to this survey.

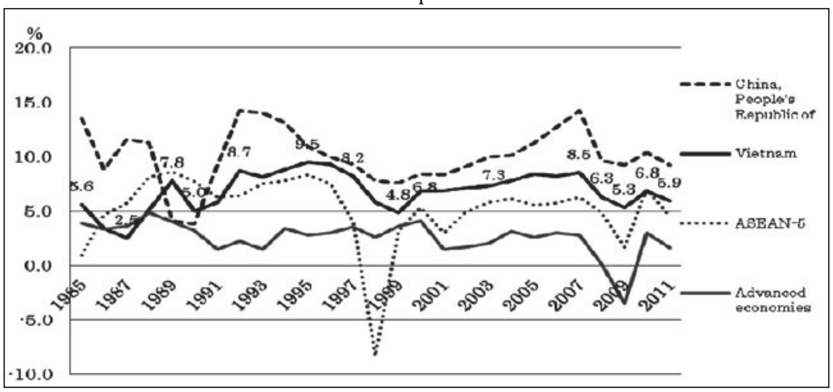
The report is outlined as follows: Part I features Vietnam's economic growth; Part II discusses the "Middle Income Trap"; Part III provides an overview of the present condition, issues and development potential of the Vietnamese small- and medium-scale enterprises; and Part IV presents the conclusions.

## Vietnam's Economic Growth

Vietnam has experienced a high rate of real economic growth since the 1980s. The shift from agricultural collectives to a contract system, which took place in the early 1980s, was later expanded throughout the economy, and in December of 1986 developed into the Doi Moi policy. This policy promoted the creation of a market in the domestic economy, integration with the international economy, and macroeconomic stability, supporting the ensuing high-growth. Figure 1 shows Vietnam's real GDP growth rate compared to that of China, NIEs, and other advanced economies. The figure shows that after the adoption of the Doi Moi policy, Vietnam achieved high economic growth that was basically maintained entering this century. Obviously, the largest growth was shown in China, which has been leading East Asia since the 1990s, followed by Vietnam.

In 1999, the currency crisis made Vietnam's real economic growth rate bottom out to about 4.8 percent, but it immediately turned around and achieved an average of 7.3 percent growth rate between 2000 and 2010. In 1990, Vietnam's GDP was around US$6.5 billion. In 2000, it reached US$31.2 billion, and US$136.4 billion in 2010, exceeding US$100 billion for the first time. Vietnam recorded an average of 7.4 percent real economic growth rate between 1990 and 2010 (IMF World Economic Outlook Database).

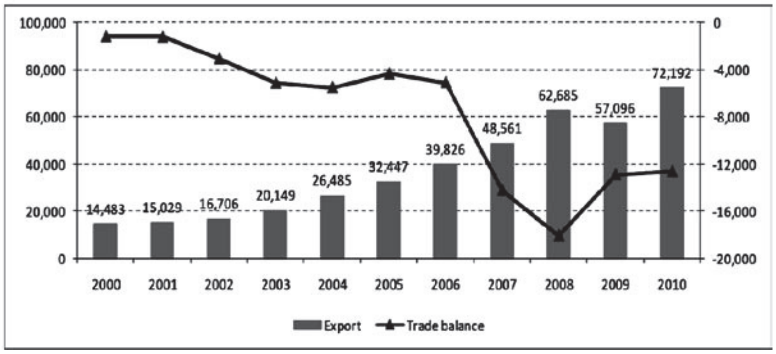
Figure 1. A Comparison of the Economic Growth Rates of Vietnam and the Main Economic Groups of the World: 1985-2011




Note: ASEAN5 consists of Indonesia, Malaysia, Philippines, Thailand and Vietnam
Source: complimented from IMF (2012) World Economic Outlook Database, October 2012 Version.

What caused this growth to happen so rapidly? The GDP dependence on foreign trade was about a mere 23.2 percent at the time of adoption of the Doi Moi policy in 1986. It dramatically rose to 74.7 percent in 1995 and to 171.1 percent in 2008. In 2009, this number dropped to 147 percent due to the world financial crisis, but it started recovering in 2010 when it reached 165.3 percent (World Databank). Figure 2 shows the growth of Vietnam's foreign trade values and its trade balance. Due to the 2008 world financial crisis, there was an abrupt deterioration in the foreign trade balance, but was recovering after that. Using IMF statistics, we checked the size of the current account deficit as a percentage of GDP. Up to 2006, this ratio stayed within the level of minus several percent, but abruptly dropped to minus 9.8 percent and minus 11.9 percent in 2007 and 2008, respectively. It has recovered right away and was only minus 0.5 percent in 2011 (IMF, 2013). Domestic industries such as manufacturing and construction showed a considerable increase as a percentage share of the Vietnamese GDP from 28.7 percent to 41.1 percent between 1995 and 2010 (GSO, 2008; 2010). One could say that Vietnam's development stood on the pillars of trade and manufacturing during the same period.

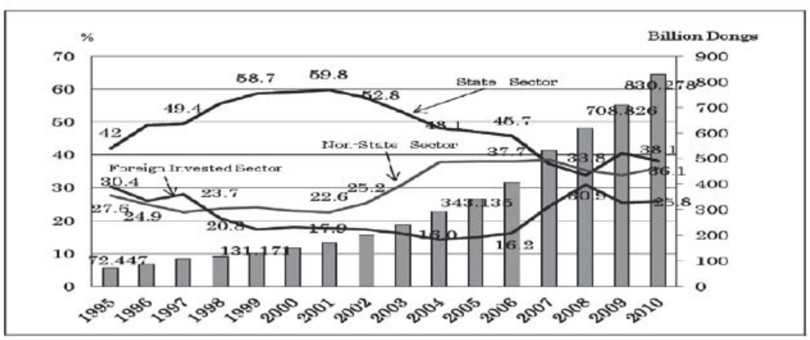
Figure 2. Vietnam's Exports and Trade Balance
(2000-2010) (Units: million US$)




Source: Created from General Statistical Office (2008-2010).

Accordingly, Figure 3 shows the percentages of investment that went into manufacturing, in terms of ownership. From the late 1990s up to the beginning of this century, investments by the state did expand, but has since then dropped sharply while shares of the non-state and foreign investors (FDI) expanded. A growth based on rivalry amongst these three groups can be seen. This paper refers to this as the tri-sector foundation growth structure.

Figure 3. Composition by Ownership of Vietnam's Investment and Growth of Investment at Current Prices: 1995-2010




Note: growth rate (av. in year) 2010/1995= total 17.7%, State 16.9%, Non-state 19.8%, Foreign 16.4%
Source: computer from General Statistical Office, Vietnam (2008: 2010) Statistical Yearbook of Vietnam, Hanoi.

Yet, if the state and non-state (private) sectors are combined and viewed as the domestic sector, an issue arises when comparing this sector's production to that of the FDI sector. Table 1 shows the production of the domestic sector dropping significantly from 74.9 percent to 59.5 percent between 1995 and 2008, while that of the FDI sector rose from 25.1 percent to 40.5 percent during the same period. In short, what should be done about this tendency toward a linear expansion of the share of the FDI sector and the shrinking share of the domestic sector in the domestic production? Indeed, FDI from abroad to Vietnam is an important condition for Vietnam's development. As shown in Figure 4, there was a big decline in the recorded capital values as a result of the global financial crisis, but the actual investment values continued to steadily increase post-1990s. This supported growth of the FDI sector.

Table 1. A Composition of Domestic and Foreign Investment in the Domestic Production

| | Domestic Capital Output Share | FDI Output Share | | Domestic Capital Output Share | FDI Output Share |
|---|---|---|---|---|---|
| 1995 | 74.91 | 25.09 | 2004 | 63.96 | 36.04 |
| 1996 | 73.27 | 26.73 | 2005 | 62.72 | 37.28 |
| 1997 | 71.08 | 28.92 | 2006 | 61.65 | 38.35 |
| 1998 | 67.36 | 31.98 | 2007 | 60.77 | 39.23 |
| 1999 | 65.25 | 34.75 | 2008 | 59.69 | 40.31 |
| 2000 | 64.06 | 35.94 | 2009 | 59.33 | 40.67 |
| 2002 | 64.57 | 35.43 | 2010 | 58.76 | 41.24 |
| 2003 | 64.22 | 35.78 | 2011(Pre.) | 58.16 | 41.84 |

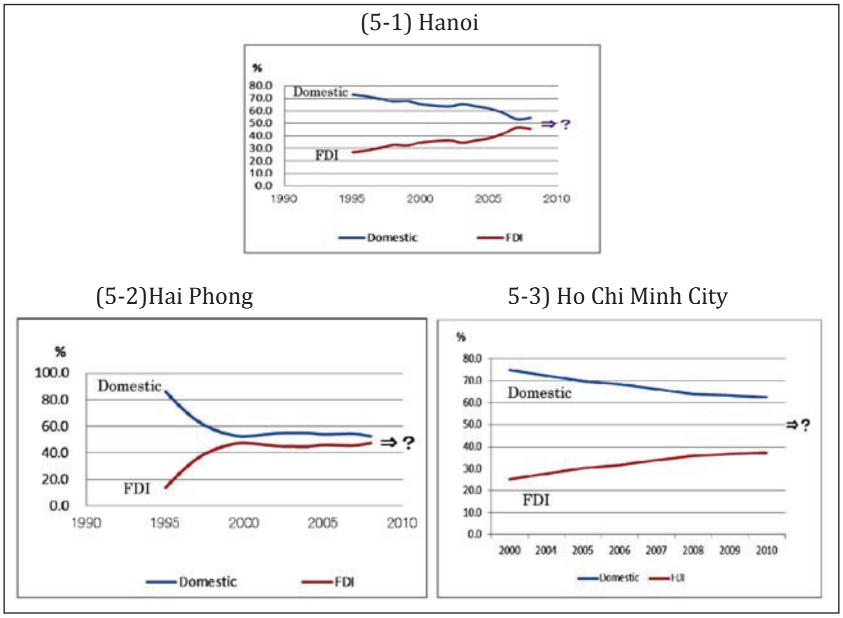
Source: Same as the previous figure, but missing data for 2001. Figures after 2009 are from the 2011 issue of the same publication.

Let us here confirm a very interesting fact. Checking production in terms of capital structure for the three main cities of Hanoi, Hai Phong, and Ho Chi Minh, we can see the following phenomena: In 1995, Hanoi received roughly half of its investment from total FDI. Towards 2000, Hai Phong's share of domestic sector was declining towards the 50 percent mark, but flattened out before reaching that point and remained above the 50 percent mark. With regard to Ho Chi Minh, since 2000, the domestic capital portion decreased close to 60 percent from about 75 percent, while the FDI sector's portion was steadily rising from 25 percent towards 40 percent during the same period. How would the correlation of these two sectors evolve in the future? It is conceivable that a kind of junction will be reached.

Figure 4. Foreign Direct Investment to Vietnam (1988-2010)


Here we would like to note that, within its economic growth to date, Vietnam's domestic sector could be construed as having smoothly grown together with the FDI sector. So far, a relationship of mutual growth has been created between both the sectors. It could be said that Vietnam is now at the crossroads as to how to maintain and develop this structure. In short, there are future possibilities, as shown in Figure 5[1]: 1) reducing the share of the FDI sector by strengthening the domestic sector; 2) strengthening instead the FDI sector as the domestic sector's share declines; and 3) rigidly maintaining the current situation. Incidentally, the above development prospects will accomplish any one of the following: 1) a U-shaped, symmetrical development (the domestic sector will be in a U-shaped style, and the FDI sector will be in an inverted U-shaped style); 2) an X-shaped development; or 3) a parallel-shaped or Other-shaped symmetrical development. Vietnam's development prospects must be either U-shaped symmetrical or parallel or Other-shaped symmetrical from the Vietnamese view point.

Figure 5. Output Composition of Domestic Investment in Vietnam, 1995-2008




Source: Taken from Figure 5-1, 5-2 of Than, Nguyen, and Hirakawa (2011). Figure 5-3 was created from General Statistical Office, Vietnam (2011).

## Vietnam and the "Middle Income Trap"

In 2007, the World Bank report, *An East Asian Renaissance,* predicted that, if the East Asian region would continue its current growth, its share in the world economy by 2025 would have reached the same level it occupied in 1820 (40%) (Gill & Kharas, 2007). It indicated that with the predicted entry of Vietnam into the middle-income country group in 2010, more than 95 percent of East Asia's people will be leading middle-income lives. The fact that East Asia is a middle-income region, with more countries increasingly looking for strategies to move into a rich-country group, is important because patterns of growth change according to changes in income levels. The road ahead is said to have two directions. One is towards economic affluence wherein the industrial diversity is preserved. Another one is the road of development through specialization in one kind of industry.

However, being in the middle-income country stage, it would not be possible to become a high-income country without doing something different from the conventional. This is called the "middle-income trap" in which a middle-income country could be trapped between the low-wage poor country competitors dominated by mature industries and the rich-country innovators dominated by industries able to rapidly change technologies (Gill & Kharas 2007, p. 4-5). The growth of East Asian countries has been conventionally based on economies of scale. However, in order for these countries to go beyond the middle-income status, and grow to surpass the past generation and become high-income economies, the focus must be on technologies that successfully guided middle-income countries (Gill & Kharas, 2007, p. 18). As such, the report will focus its investigation on China, Indonesia, Malaysia, the Philippines, and Thailand.

This became an important issue in the ensuing East Asian growth discussions. The Asian Development Bank (ADB) report, *Asia 2050: Realizing the Asian Century*, states that if the recent East Asian growth continues, East Asia would account for more than half of the world's GDP, trade and investment by 2050, and enjoy a widespread affluence. East Asia's share of the world GDP would grow to 50 percent in 2050 from 27 percent in 2010. By doing so, Asia would regain the dominant status it occupied in the world 250 years ago, before the industrial revolution. At the same time, the report separated the Asian economy into three groups based on performance for the past 25 years. The first group is composed of seven economies (Brunei, Hong Kong, Japan, South Korea, Macau, Singapore and Taiwan), which became high-income advanced economies in one generation. The second group includes the huge economies of China and India, which have consistently shown high growth since the 1990s and have already reached middle-income status, but confront the risk of falling into the middle-income trap. This group consists of 11 economies (Armenia, Azerbaijan, Cambodia, China, Georgia, India, Indonesia, Kazakhstan, Malaysia, Thailand and Vietnam). Lastly, it is the group of 31 countries, including the Philippines, in Asia's three regions[2] (East Asia, Pacific region, and South Asia), which continue to grow at a low rate over a long period of time (ADB 2011, p. 1).

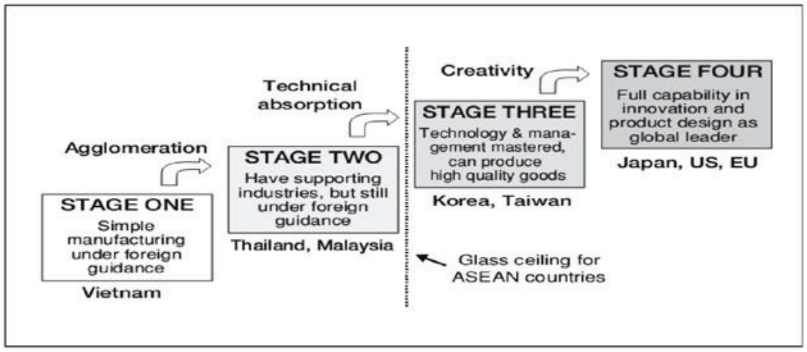
Needless to say, our focus here is how the second group will develop into the high-income advanced country. The ADB reports that these countries could fall into the middle-income trap within the next five to ten years.

> Some features differentiating growth beyond middle income from growth from low income to middle income are clear. Growth tends to become more capital-intensive and skill-intensive. The domestic market expands and becomes a more important engine, especially for the growth of services. Wages start to rise, most rapidly for highly skilled workers, and shortages can emerge. The traditional low-wage manufacturing for export model does not work well for middle-income countries. They seem to become trapped in a slow growth mode unless they change strategies and move up the value chain… A majority of Asian economies—including PRC, India, Indonesia, and Vietnam—still have to demonstrate their ability to avoid this trap and the resulting slow growth experienced by much of Latin America. (ADB, 2011, p. 33-34).

This "middle-income trap" discussion, which bears in mind a comparison with Latin America, has caught the attention of China, Thailand and Vietnam (Tran, 2010; Cai, 2012; *The Economist*, 2012; Felipe, 2012; Jankowska, Nagengast & Perea, 2012). In his latest publication, *Vietnam Economic Development Theory: The Middle Income Trap and a New Doi Moi*, Tran Van Tho, a Vietnamese economist active in Japan, states that Vietnam's further development is moving from the current growth stage to the next stage, and that a new Doi Moi policy is necessary. He considers as "already valid" the premises and methods of the simulation of the Next 11, a term which has been coined and chosen by Goldman Sachs to identify the next group following BRICs. He shared the prediction that Vietnam, which was ranked 56th in terms of current GDP in 2005, would become 17th in 2025 with a GDP of US$436 billion, and said that around 2020 would enter the fellowship of high middle-income countries (Tran, 2010, p. 292). Goldman Sachs developed a Growth Environment Score (GES) based on indicators on the following five factors: 1) macroeconomic stability (inflation rate, government bonds, foreign indebtedness); 2) macroeconomic conditions (investment rate, economic openness); 3) technological ability (PC, telephone, Internet diffusion rate); 4) human capital (education, lifespan); and 5) political conditions (political stability, legal system control, corruption). Based on these, Vietnam is counted among the highest scoring group, together with South Korea, China, Mexico and Russia (O'Neill, Wilson, Purushothanam & Stupnytska, 2005, p. 10).

The same problem awareness is shared by the Policy Support Research of the Vietnam Development Forum, which was established in 2003 by a 21st Century COE Program grant of Japan's Ministry of Education, Culture, Sports, Science and Technology (MEXT). This program was created as a venue for joint research between National Graduate Institute of Policy Studies Professor Kenichi Ohno and others, and the National Economics University in Hanoi, Vietnam. The program promoted the legacy left behind by the late Shigeru Ishikawa, Professor Emeritus of Hitotsubashi University, who made a comprehensive survey of Japan's official development assistance to Vietnam between 1995 and 2001. In 2006, a report on *The Industrial Development of Developing Countries and Japan's Involvement* was published (Ohno & Fujimoto, 2006), which pursued development policies based on Ohno's four-stage hypothesis of Catch-Up Industrialization.[3] As shown in Figure 6, the first stage of the Catch-Up Industrialization is simple assembly, processing and fabrication under foreign guidance. The second stage is the formation of supporting industries, yet under continued foreign guidance. The third stage is the mastering of technology and management, to enable the production of high-quality products. The fourth stage is becoming a global leader able to innovate and develop products. A glass ceiling exists in the catch-up between the second and third stages. South Korea and Taiwan already crossed the ceiling, but neither Thailand nor Malaysia has gone beyond. Ohno's writings showed that Vietnam, which was in the process of moving from the first to the second stage, holds a possibility of crossing the glass ceiling in the future, and proposed the necessity of preparing for any obstacle so as not to be blocked by this ceiling. Ohno asserted that Vietnam, which was known for its skillful, diligent and persevering workers, must go beyond the glass ceiling by improving its industrial competitiveness by upgrading its policy ability (Ohno & Fujimoto, 2006, p.15).

Figure 6. Breaking Through the "Glass Ceiling"




Note: In this figure, Ohno puts Vietnam in the first stage, but in 2009, after his writing, Vietnam surpassed the US$1000 per capita GDP mark, and at the end of 2010 was formally recognized by the World Bank and the Asian Development Bank as a middle-income country. However, he still puts Vietnam's position at the same stage.
Source: Ohno (2006, p.15).

The program published the report *Vietnam as an Emerging Industrial Country: Policy Scope Toward 2020*, and dealt with the main issue of Vietnam basically becoming an industrial country by 2020. In the "Preface to the Preview Edition" published on the Internet, Ohno wrote as follows:

> At present, there seems to be too much emphasis on achieving macroeconomic targets such as growth, investment and exports, and not enough interest in monitoring the process of quality changes in technology, education, living conditions and industrial competitiveness. Old mentality and passive complacency must be replaced by strategic positioning and pro-active thinking. These are necessary for mapping the future development path, coping with global competition, and avoiding the middle-income trap. (Ohno, 2008).

In chapter 1, "Current Status and Future Possibilities," of the same preliminary edition, four features of Vietnam—that is, the strengths and weaknesses—were enumerated: 1) the acceleration of Vietnam's international integration; 2) the promotion of dynamism through private investment and consumption; 3) the introduction of foreign direct investments; and 4) the necessity for reforms in the policy framework. With regard to the fourth feature, Vietnam's policies and systems are even lower than the general level of a developing country. By leveraging or reforming these features, the major ASEAN countries, excluding Singapore, have opened the possibility of going beyond the unbreakable "glass ceiling."

What would be the "glass ceiling" according to Ohno? How could this be overcome? With regard to this ceiling, Ohno is trying to find a direction in Vietnam's development based on the Product Architecture Theory (Design and Fundamental Thought) of Takahiro Fujimoto. In product architecture, Fujimoto asserts that there is the "Integral Type," wherein an optimal product is born only when parts' design is jointly adjusted, and the "Modular Type," wherein an optimal product is produced by simply assembling standardized parts (modules). Based on this perspective, China is a modular type, while ASEAN, particularly Vietnam, is an integral type close to Japan. Consequently, Vietnam should develop an integral type of industry through human resource development (Ohno, 2006, p. 22).

Incidentally, at the heart of the development stage hypothesis that leads to the prospect of the "middle-income trap" lies the five-phase economic development theory of Masahiko Aoki, which focuses on the relationship between population dynamics and economic systems (Aoki, 2011a; 2011b). In his 2011 papers, he highlighted the similarity in the development patterns of Japan, China and South Korea as having passed through the five phases of economic development, including the Malthusian (M), the Government-led (G), a la Kuznets (K), the Human Capital-based (H), and lastly, the Post-Demographic Transition (PD). The dominant share of employment in the M phase is in agriculture, accounting for 80 percent, and the per capita income is stagnant at low levels. This is followed by the G-phase as the first post-Malthusian phase, in which the government aggressively intervenes in the industrial accumulation and increases industrial employment. The second post-Malthusian phase, the K-phase, comes in, wherein agricultural employment drops, the level of affluence being endowed with "a quantitative aspect of economic growth" rises, and infant mortality rates decline.

This then leads to the H-phase of self-reliant growth, which depends on the improvement of industrial labor productivity linked to growing per capita GDP, in particular, to the Total Factor Productivity (TFP) and human capital investment. The indicator is the reduction of agricultural employment population to levels below 20 percent. The "Middle-Income Trap" appears during the transition from the

K-phase to the H-phase. If the TFP and human capital investment is not smoothly made, stagnancy occurs. The H-phase overcomes this obstacle. However, population reduction occurs with the entry of the PD-phase. South Korea and China are now shifting to the H-phase, and Japan is at the entry point to the PD-phase Aoki, 2011b, p. 3-7).

Aoki's paper focuses on Japan, China and South Korea, but does not discuss the Vietnam case. However, this hypothesis could be adapted to Vietnam's development. In the rapidly developing latecomer country of Vietnam, there is a high possibility of the G- and K- phases developing simultaneously in an abbreviated manner, but in order to catch up with high-income countries, a shift to the H-phase in the very near future is particularly important.

Table 2 shows the factor analysis based on the growth accounting of Vietnam's mid-term social economic development plan as adopted in 2010. According to this plan, Vietnam is to grow at an average of 6.51 percent annually in 2010 to 2019. In the latter half of this period, the level of contribution of capital and labor will drop, while only that of the TFP will be fixed at 2.81 percent (43.1% of the total contribution), which is expected to be the highest level of contribution. Needless to say, achieving high-value-added is indispensable.

Table 2. The Factor Decomposition of Vietnam's Growth Plan Based on Growth Accounting, 2010-2019

| Period | GDP Growth Rate | Capital Contribution | Labor Contribution | Total Factor Productivity TFP) Rate of Increase |
|---|---|---|---|---|
| 2010-2014 | 6.79 | 2.90 | 1.08 | 2.81 |
| 2015-2019 | 6.22 | 2.62 | 0.79 | 2.81 |
| 2010-2019 | 6.51 | 2.76 | 0.94 | 2.81 |

Source: Paper prepared for the Knowledge Sharing Program (KSP) for Supporting the Establishment of Vietnam's Mid- and Long-term Socio-Economic Development Policies (2010). (Cited from Nguyen Thi Bich Ha's materials submitted to Nagoya University ERC's 26th International Conference on "From the Crisis to a New Growth: Global Financial Crisis, Great East Japan Disaster and East Asia," Oct. 28, 2011.)

How would it be possible to avoid the "Middle-Income Trap"? As seen in the factor analysis in the previous section, the key would be the role of the private sector, which would support the campaign of the tri-sector foundation development structure.

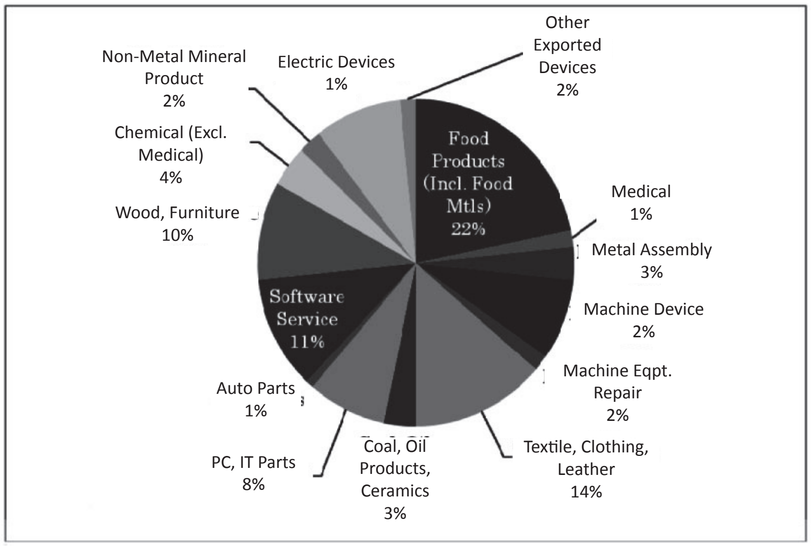
In the development of the private sector, the link with foreign-affiliated firms in particular will play an important role, but this is not the only development trajectory for local firms. It would also be necessary to take a look at the human resource development of private firms themselves, while keeping the links with foreign capital in mind. The development thinking of firms within a rapidly changing society would play a major part in supporting the development of Vietnam from hereon. If the shift to a middle-income economy is to be accompanied by a change in society itself, the main concern of local firms that have risen since the Doi Moi policy is responding to and coping with such change. In order not to fall into the trap, their concern and ability for innovation would be essential.

What could be predicted at this point is the existence of a large gap between the management and reform orientation of local firms. However, finding the bud of Vietnam's development would be an extremely important task in raising the development potential of Vietnam.

## The Human Resources Potential and Issues of Vietnam: Looking at a Survey of Local Firms

**Overview of the survey.** The questionnaire survey[4] targeted Vietnamese local firms as subjects during the period of May to October, 2012. The survey was carried out with the cooperation of the Vietnam Chamber of Commerce and Industry. We requested responses from individual firms, and received responses from a total of 192 firms from the Northern, Middle and Southern regions. Among the total of 192 firms, we were not able to identify the regions from survey forms collected for 73 firms. Hence, these were considered defective in terms of classification by region. The distribution of industry was the following, excluding the firms which chosen "others" (47%); Food Products (22%), Textile, Clothing, Leather (14%), and Software Service (11%) and so forth as Figure 7 shows.

Figure 7. Type of Business (Q5)[5]



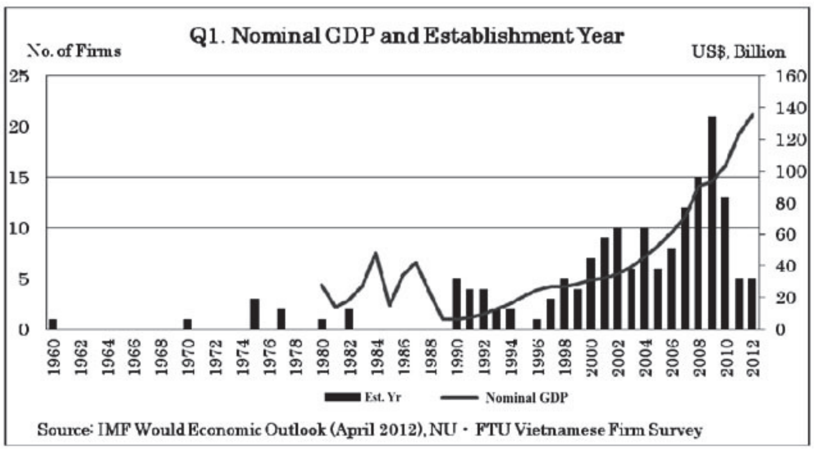

Source: NU-FTU Vietnamese Firm Survey (2012).

By way of clarifying the significance of this survey, as was indicated in the previous section, Vietnam, in the not-so-distant future, faces the possibility of falling into the so-called "middle-income trap." An important condition for this to be avoided or resolved lies in the ability of the Vietnam's local firms to develop. Vietnam's recent development was realized due to a balanced development of the public, private and foreign sectors. The ideal development from hereon would involve the achievement of the structure pushed by the domestic sector within the relationship of the Vietnamese domestic and foreign sectors. For this, according to Ohno's hypothesis, Vietnam must climb to the third stage from the second stage, breaking through the glass ceiling. And, according to Aoki's hypothesis, Vietnam must go beyond the G and K phase to the H phase or combine G, K and H phase in order to continue its development toward high per-worker-product economy. After all, for Vietnam, one of the most important factors in the near future would be the development of the local firms and the human resources that support local firms.

Based on this awareness of the problem, this paper seeks to determine, at a general level, whether or not the local firms have the potential to avoid the middle-income trap. In the survey results pertaining to, among others, the level of education of the CEO and workers, the means of training in the work area, and the manner of conduct of employee-employer relationships, we see the possibility of the ability to cope with globalization with respect to the development of Vietnamese firms. This confirms the fact that the development of local firms supported Vietnam's economic development.

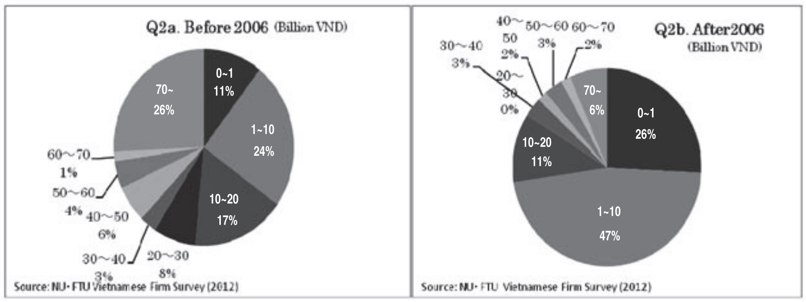
**Vietnamese local firm as seen from the questionnaire survey results.** In Vietnam, since the 1990s and especially upon entering this century, the development of private local firms gave birth to economic vitality. This fact could also be confirmed from the survey. The number of survey respondent firms establishing their business started to rise from the second half of the 1990s, and has been rapidly rising since the start of this century. Moreover, as shown in Figure 8 (Q1), it is remarkably moving in line with growth of the GDP.[6]

Figure 8. Vietnam's Nominal GDP and Year of Firm Establishment (Q1)




One of the features of these local firms, as can be confirmed from Figure 9 (Q2a and Q2b), is that there has been a growing number of investors with small-scale capital in recent years. This fact is possible proof that development vitality is spreading throughout the entire economy.

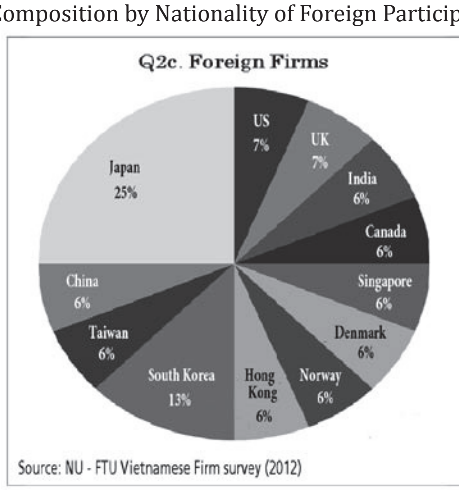
Figure 9. Composition of Establishment Years of Respondent Firms (Q2a, Q2b)




Only a few of these firms have alliances with foreign firms. In this survey, the share of firms that have joint ventures with foreign firms do not exceed 8.3 percent, and most of the firms have no relations with foreign firms. Moreover, the fact that the locations of these firms are outside industrial complexes such as the Industrial Parks (IP) and Economic Processing Zones (EPZ) shows that the local firms are widely formed.

Incidentally, as shown in Figure 10, for those firms that have links, these links are characterized as joint ventures with a diverse nationality of foreign-affiliated firms. This reflects the openness from the outset of the foreign liberalization policy of the Vietnamese government, and the active entry of Western and Asian firms, excluding Japanese firms.

Figure 10. Composition by Nationality of Foreign Participating Firms (Q2c)

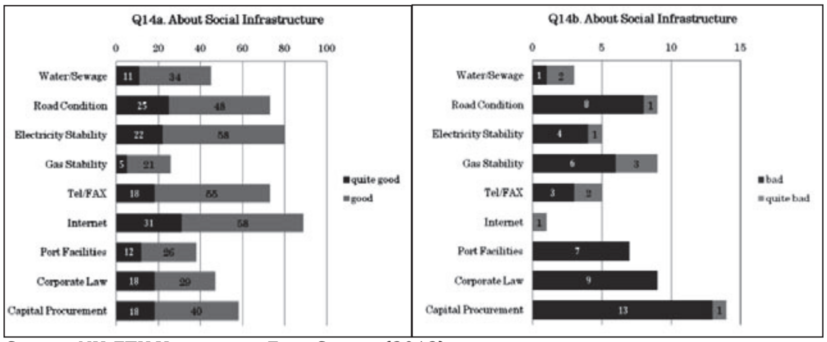


In terms of management status, the global financial crisis did have an effect, but it is relatively minimal. At the same time, there are a lot of firms with no exports. Basically, their business activities are geared towards the local market. Looking at rival firms and rival products, the management environment is such that the major competitors are local and Chinese firms, and products from Taiwan, South Korea and ASEAN. In terms of the source of a firm's competitiveness, the price and quality of products were the most important, followed by human resources and marketing ability.

An interesting survey result is the awareness related to social infrastructure. As shown in Figure 11, half of the firm respondents were relatively satisfied with the provided infrastructure. In particular, satisfaction was high in items such as the Internet environment, stability of electricity supply, and road conditions. Since one of the areas of concern related to investments in Vietnam—as seen in surveys conducted by the Japan External Trade and Organization (JETRO), the Japan Bank for International Cooperation (JBIC) and the like—is the backwardness in the provision of infrastructure, there is a large gap in the perceptions between local and Japanese firms. This may reflect the differences in the relative standards between the Japanese firms, which would spatially compare the investment environment with other countries, and the local firms, which would temporally compare with the past. At the same time, it might show the rapid improvement in Vietnam's corporate environment. The issue is that a lot of firms encounter difficulty in the procurement of capital. Either way, it could be said that government support is particularly required in these areas. The terms of competition are ultimately decided based on the international comparison. Hence, awareness of this feature of globalization is necessary in order to formulate objective evaluations and counter policies.

With respect to the management status, as is observed from the questionnaire results in Figure 12, half of the respondent firms indicated that it is becoming better. The reasons given included the improvement in "quality of employees," "technological capability" and "product quality." With respect to the deterioration of the environment, the reasons given were "the rise in the cost of materials," "electricity fees," and "wage increases." It could be said that the environment is becoming one that must guide the direction of Vietnam's development in the future towards achieving high value-added management.

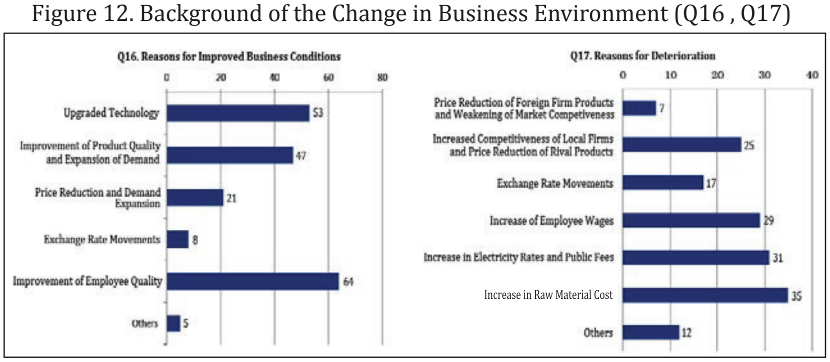
Figure 11. Evaluation of Social Infrastructure (Q14a, Q14b)




Source: NU-FTU Vietnamese Firm Survey (2012).

With respect to responses regarding current issues, though figures are not shown, "the rise of lending rates" was cited the most, followed by "rise in procured parts and material costs," "rise in wages," "macroeconomic instability," "product price," and "acquisition of skilled employees." The main issues revolve around the rise in capital procurement cost and its access, rise in employee wages and resulting product price problem, and macroeconomic instability.

Figure 12. Background of the Change in Business Environment (Q16 , Q17)




Source: NU-FTU Vietnamese Firm Survey (2012).

Future issues include "product price" and "product quality" as priority, followed by "rise in lending rates," "procurement of capital," "rise in wages," "acquisition of skilled labor," and "acquisition of new workers." There is indeed an awareness of the importance of issues related not only to product but also to capital procurement, rise in wages, and the acquisition of workers themselves. In the meantime, the situation is such that firms are hard pressed in the areas of product, capital and the acquisition of skilled and unskilled workers.

With respect to affiliations with foreign firms, half of the valid firm respondents indicated that they have such affiliations. Japanese firms have the highest number of links with local firms, followed by Korean, Chinese and American. Others included Taiwanese and ASEAN firms. The diversity of foreign firms likely reflects the history since the Doi Moi reforms—the first entrants were NIEs and ASEAN firms, followed by Western firms. As shown in Figure 13 (Q20b, Q21), transaction relations with foreign firms are dominated by "export of products," "procurement of materials," "purchase of products," "consultancy," and "provision of manufacturing technology." The transaction relations involving sales of products and procurement of materials occupy the central spot. There are also a few consultancy and technological guidance transactions, which exemplify cases of acquiring management technology and know-how from overseas firms. Firms with Original Equipment Manufacturers (OEM) contract relations can also be confirmed. Here, 'OEM Contact 1' refers to firms (subcontractors) that manufacture products wherein the marketing, design and materials are provided by foreign firms (contractors); 'OEM contract 2' refers to firms (subcontractors) that can manufacture, in the sense of using materials, but cannot do marketing and designing; and 'OEM contract 3' refers to firms (subcontractors) that themselves design and manufacture products for foreign firms (contractors).[7]

Regarding the relation between "strengthening competiveness" and affiliation with foreign firms, more than 40 percent of the respondent firms found affiliating with foreign firms beneficial in areas such as "product/business making" and "enhancing manufacturing process efficiency." Gaining "information on markets and products" and doing "product marketing" also seem to be important. The effects of these responses could be seen in product manufacturing and sales of local firms. Above all, the limited relation with foreign firms is still an issue of concern.

Next, we checked the questionnaire survey with respect to human resource development. As pointed out, recent business startups are characterized by small-scale capital, and this is also manifested in their small-scale employment. As shown in Figure 14 (Q22a, Q22b), majority are firms with less than 100 employees. In this category, firms with less than 10, 10-20 and 21-30 employees predominate.

Figure 13. Competitiveness of Transaction Types of Foreign Firms (Q20b, Q21)

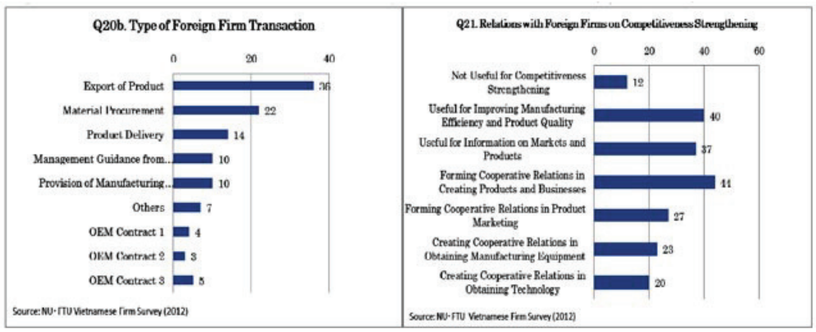
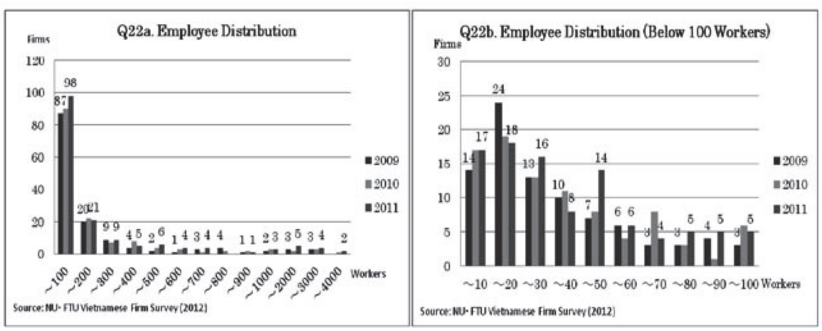
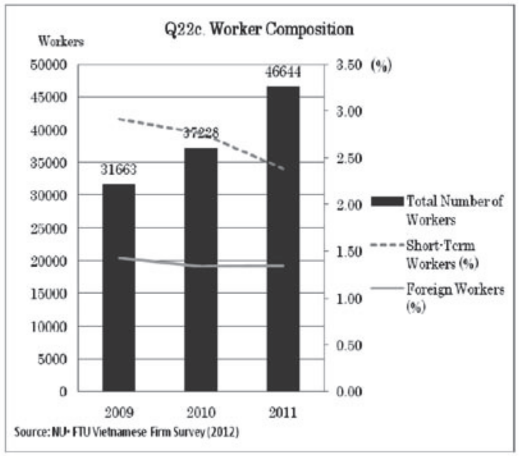



Figure 14. Composition by Employee Size (Q22a, Q22b)




In Figure 15 (Q22c), looking at the movements in the number of employees, short-term contracts, and foreigners employed for the past three years, it is found that the number of employees increased 1.5 times. The share of foreigners employed remained fixed, the share of short-term employment dropped, and both shares are at low level. This shows that the recent startups of small- and medium-scale enterprises have been providing large employment opportunities in a way that do not create gaps among employees.

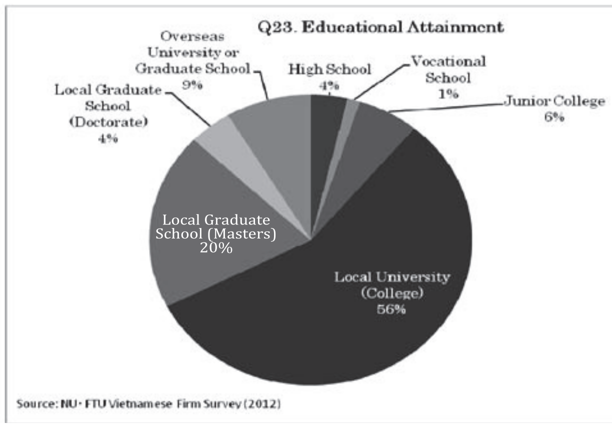
Figure 15. Worker Composition (Q22c)




According to the questionnaire survey, as shown in Figure 16 (Q23), in terms of educational attainment of the firms' chief executives, local university graduates or those completing graduate studies comprise 80 percent of the total, while vocational school graduates are very few. The tendency towards high educational attainment is remarkable. In today's enterprises, knowledge and information are highly important, and are of a different quality than that of traditional small- and medium-scale enterprise models that were once seen in Japan. At the same time, the managers' high educational attainment would indicate that Vietnam's local firms have the ability to respond to policy support.

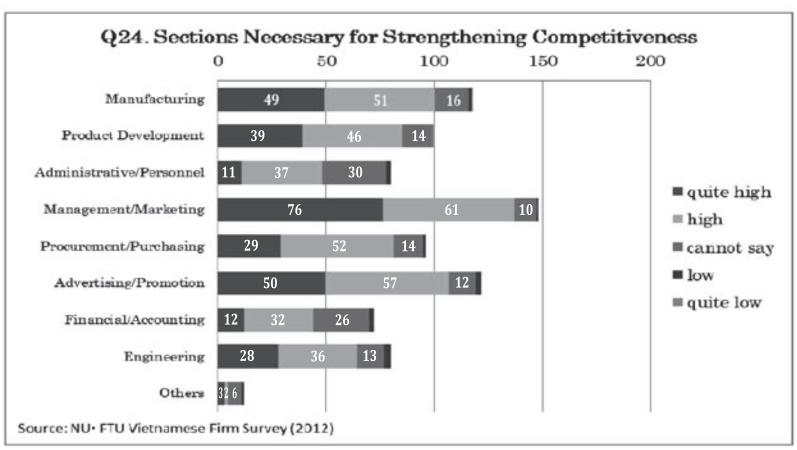
Figure 17 (Q24) represents an investigation into the future development direction of Vietnam's local firms. By looking at sections necessary for strengthening competitiveness, it is revealed that "management and sales section," which garnered a large number of responses, is critical in strengthening competitiveness. This is followed by "advertising and promotion," "manufacturing," and "product/ development." The order of sales, production, and product development shows that after the resolution of pressing issues, the next step would be towards the strengthening of product competitiveness.

Figure 16. Educational Attainment of Chief Executives of Local Firms (Q23)



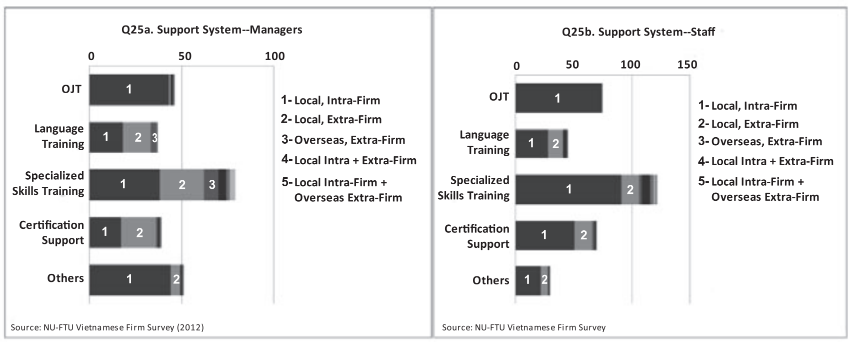

With respect to the development programs focusing on the education of managers, a very interesting result was obtained. From Figure 18 (Q25a, Q25b), which looks at the support systems available for managers and staff, "intra-firm training" is naturally dominant. Items such as "specialized skills training," "language training," and "certification" are equally important. With respect to the necessary support system in the future, "specialized skills training," followed by "OJT" and "language training," are cited the most.

Figure 17. Sections Necessary for Competitiveness Strengthening (Q24)



Regarding management, it could be said that there is a strong awareness of the importance of acquiring firm competitiveness, which is clear from the focus on "specialized skills training" of managers and staff. The results can indicate a sense of tension in the management section of local firms facing globalization, even among local small- and medium-scale enterprises.

Figure 18. Support Systems for Competitiveness Strengthening (Q25a, Q25b)




With respect to the employees on the shop floor, almost all responses indicated intra-firm training as an important source, with training items such as "specialized skills training," and "OJT" occupying prominent responses. From the responses to questions on employee absence without permission and labor problems, we can see that incidences of absence without permission and labor problems are relatively few. The ever-increasing competition, in many cases, directly burdens employees through wage increases, but in this survey its degree of severity is relatively low. It does not limit the development possibility of the local firms. On the contrary, it holds the hidden possibility of collaboration.

This is only a general survey, but its results are rich in implications. Apparently, Vietnam provides a case for the potential to overcome the "middle-income trap" or "glass ceiling" that could lead to a clear objective and policy support.

## Conclusion

In this report, it is shown that Vietnam's economy has grown fast after the adoption of the Doi Moi policy, which triggered exports and the acceptance of foreign-affiliated firms through economic liberalization. However, we have confirmed that the energetic activities of local firms also support Vietnam's economy. We have described its development as a tri-sector foundation development, and have suggested that a U-shaped, symmetric development or a parallel- or Other-shaped, symmetrical development of the domestic/foreign sector is a desirable development framework for Vietnam's future.

In the second chapter, we did an overview of the "middle-income trap," which has been widely discussed in recent years, and highlighted the possibility of Vietnam falling into this trap. At the same time, we discussed how this trap could be avoided, and cited the importance of forming local firms that would campaign for a tri-sector foundation development.

In the third chapter, we searched for development possibilities based on our own questionnaire survey of Vietnamese local firms conducted between May and October of 2012. We confirmed that local business startups of recent years have a lot of social foundation, and have provided employment opportunities. There are problems such as small exports and weak relations with the overseas markets and firms, large dependence on the local market, difficulties in "materials procurement," "capital procurement," and "wage increases," but there is already a steady development. The direction of this development is such that there is high awareness about the importance of upgrading, on top of the existing foundation, of "marketing capability," "quality of employees," "product price," and "product quality." Moreover, the high educational attainment of Vietnam's managers, irrespective of small- and medium-scale enterprises, holds hidden possibilities of further development in the future. Even in the case of employee relations, stable employment and a possibility of collaboration between employers and employees have been revealed. Indeed, the awareness of the outside world is limited as could be seen in the evaluations of social infrastructure, but there is a potential to overcome the issue through appropriate policy measures in the future. It would not be mistaken to say that Vietnamese local firms have the potential to campaign for a tri-sector foundation development.

Above all, the development of private sector in general, and small and medium-scale enterprises in particular, is indispensable for ensuring employment and, at the same time, maintaining vitality in Vietnam. A policy support framework for private local firms is needed for the acquisition and strengthening of competitiveness in order to avoid the "middle-income trap." There is no exaggerating the importance of this matter.

## Endnotes

[1] The sum of Domestic and FDI shares is equal to 100 percent, which means the graphs in Figure 5 are naturally symmetric about a horizontal axis.
[2] Asia, as is defined in the ADB report, consists of Afghanistan, Bangladesh, Bhutan, Cook Island, North Korea, Fiji, Iran, Kiribati, Kyrgyz, Laos, Maldives, Marshall Islands, Micronesia, Mongolia, Myanmar, Nauru, Nepal, Pakistan, Palau, Papua New Guinea, the Philippines, Samoa, Solomon Islands, Sri Lanka, Tajikistan, Timor-Leste, Tonga, Turkmenistan, Tuvalu, Uzbekistan, and Vanuatu.
[3] Ohno revised his article and changed the figure from four stages to five, adding stage zero with no manufacturing sector, such as the African countries (Ohno, 2009). Herem however, we used his old version.
[4] This survey was supported by a Grant-In-Aid for Scientific Research (KAKENHI Research Project No.23243049) from the Japan Society for the Promotion of Science (JSPS).
[5] In this section, all figure labels contain the related questions from the survey, and are given within the parentheses.
[6] According to the Vietnam Chamber of Commerce and Industry (VCCI) 2012 annual business report, "over the last 10 years, a lot of new businesses were set up, but then died prematurely. About 700,000 businesses have been set up, but only 300,000 has been found operational by early 2013" (Tran & Thuy, 2013).
[7] Hobday (1995) refers to OEM contract 3 as Own-Brand-Manufacture (OBM).

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