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## **Industrial Clustering Policy and Economic Restructuring in Vietnam**

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# INDUSTRIAL CLUSTERING POLICY AND ECONOMIC RESTRUCTURING IN VIETNAM

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## Abstract

*The study figures out the characteristics of today Vietnam's economy as well as the history of industrial agglomeration in Vietnam. Applying the conceptual framework of Kuchiki (2005), the study considers factors of industrial cluster development in Vietnam and reveals that among four types of industrial agglomerations - Marshallian industrial cluster, hub-and-spoke cluster, satellite industrial cluster, and state-centralized industrial cluster, the second type is the most suitable to the real situation of Vietnamese economic restructuring.*

**Keywords:** industrial agglomeration, industrial cluster, economic restructuring, Vietnam

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## 1. OVERVIEW

Since Alfred Marshall (1890) has discussed the impacts of industrial agglomeration<sup>1</sup> on enterprises and the development of “industrial districts”, there are a number of authors making research on such topic. Although focusing on industrial agglomeration, managerial science researchers especially focused on how enterprises cooperate to gain benefits and improve competitiveness as well as innovation and creation competencies.

*Industrial agglomeration* – (typically mentioned by NEG<sup>2</sup>) or *industrial cluster* (typically referred in management science) - is that enterprises co-locate with other enterprises in the same industry. In other words, the enterprises in the same industry and supporting industries are geographically concentrated. Not just only studying enterprises solely, management researchers also consider the relationship among enterprises and universities and/or institutes as well.

Research on industrial agglomeration referred following key points:

- Firstly, firms can receive positive externalities when geographically concentrated. The benefits include gaining a bundle of business information, making strategic partners, richness of logistic system, availability of industry specific inputs, etc. Enterprises are so excited with these impacts that if a region has good conditions for industrial agglomeration, they can attract investment even that they offer fewer preferences or labor cost is higher

than other regions. Countries having good condition for agglomeration can keep enterprises from tax and labor cost competition from other countries (Readle and Record, 2005; Ozawa, 2009; Nguyen, 2010).

- Secondly, industry agglomeration in East-Asia is encouraged by production fragmentation of transnational corporations in Japan, the US, South Korea, Taiwan, etc. Hsinchu-Taipei Corridor is an area of industrial agglomeration for IT industry as IT companies in Silicon Valley finding ODM/OEM partners in Taiwan. In turn, Guangzhou, and some Chinese coastal locations become industrial agglomeration areas as Taiwanese firms invested in (Kuchiki, 2008). Eastern Bangkok and surrounded areas, Jakarta and neighbourhood, Shanghai, Changchun (Jilin), Tianjin, Beijing, Guangdong become industrial agglomeration areas for automobile industry as Japanese and the US automobile firms coming to invest. Similar, Pearl River Delta in Guangdong, China, Penang in Malaysia, Singapore, Bangkok become industrial agglomeration areas for electronic industry. Phnom Penh and neighbours are becoming industrial agglomerations for garment, footwear industries. Kolkata (West Bengal, India), Okinawa (Japan) become the place gathering call-centers.
- Thirdly, although there is no common size in terms of area for such industrial agglomeration, the zone should not be too small because of needed places for a large number of firms. Besides, the zone should not be too large because it is dealing with service connections among firms. According to Japanese researchers, gathering zone for manufacturing should be set up under 50 km of radial distance. This is adequately for the condition that averaged commercial transaction among firms is one per day, the delivery time is lower than 2.5 hours, transportation mean mainly is truck, delivery distance is lower than 100 km. In the other words, industrial agglomeration should be suitable for JIT logistics. Meanwhile, Michael

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<sup>1</sup> Marshall identified knowledge spillovers, labour market risk pooling, and vertical linkages as the main sources of industry agglomeration economies

<sup>2</sup> The New Economic Geography - NEG is an analytical framework initiated by Paul Krugman [1][2] in early 1990s in order to explain the formation of a large variety of such economic agglomerations in geographical space, and has grown as one of the major branches of the spatial economics today. To date, the NEG remains to be the only general equilibrium framework in which the location of agglomerations is determined explicitly through a microfounded mechanism.

Porter referred to the zone of 200 miles of radial distance (equally 320 km). The US's automobile agglomeration takes Detroit as the center and stretches out followed 65 and 75 state highways through Indiana, Ohio, Kentucky, to Tennessee – extending upon corridor pattern to thousands km. The same point among such two theories is that geographical distance should help firms to meet each other to directly take transactions (Porter, 1998a, 1998b).

- Fourthly, industrial agglomeration may not be covered in one country boundaries. There are industrial agglomerations located in the border region between two countries, especially in Europe. For example, Basel located in the border region of France, German, and Swiss is agglomeration of chemical industry, Meuse-Rhine located in the border region of Belgium, Germany, and Holland is agglomeration of mechanical engineering and automobile manufacturing industry, Detroit-Windsor located in the border region of Canada and the US is agglomeration of automobile manufacturing industry.
- Fifthly, since the beginning of 2000s, as theory of industrial agglomeration and industrial cluster is growing up, there are a number of countries, especially developed countries, building up industrial clustering policy as well as regional industrial policy. Japan officially implemented industrial clustering policy since 2001, Europe is about 1999, South Korea is since 2002. Some developing countries also apply somewhat industrial clustering policy as implementing developing strategy for specific industries.
- Sixthly, industrial clusters have been impacting evidently on innovation and creations, creating strong spillover effects, developing regional economies positively. To somewhat extend, industrial agglomeration may become a growth pole.

In Global Competitiveness Report 2008, Michael Porter contributed in composing microeconomic

theory for calculating indices. He referred industrial clusters as an important factor.

About the types of industrial cluster, NEG identified four types, including:

- First, Marshallian industrial cluster is the location gathering SMEs in an industry.
- Second, hub-and-spoke cluster is the location with one anchor firm and its affiliated firms. Japan calls this type as *company town*.
- Third, satellite industrial cluster is the location gathering supporting firms.
- Fourth, state-centralized industrial cluster is the location where firms are gathered around one or several state-owned enterprises. This type is typically in national defence industry.

## **2. ECONOMIC RESTRUCTURING AND INDUSTRIAL CLUSTERING POLICY IN VIETNAM**

### **2.1. Vietnam's Economic Restructuring**

The 11th National Congress of the Communist Party of Vietnam (CPV) adopted its Resolution at the closing session on January 19. In the Resolution, CPV declared the idea of restructuring the economy with four major points: improve the economic structure, relocation of production territory, improve competitiveness, and improve effectiveness.

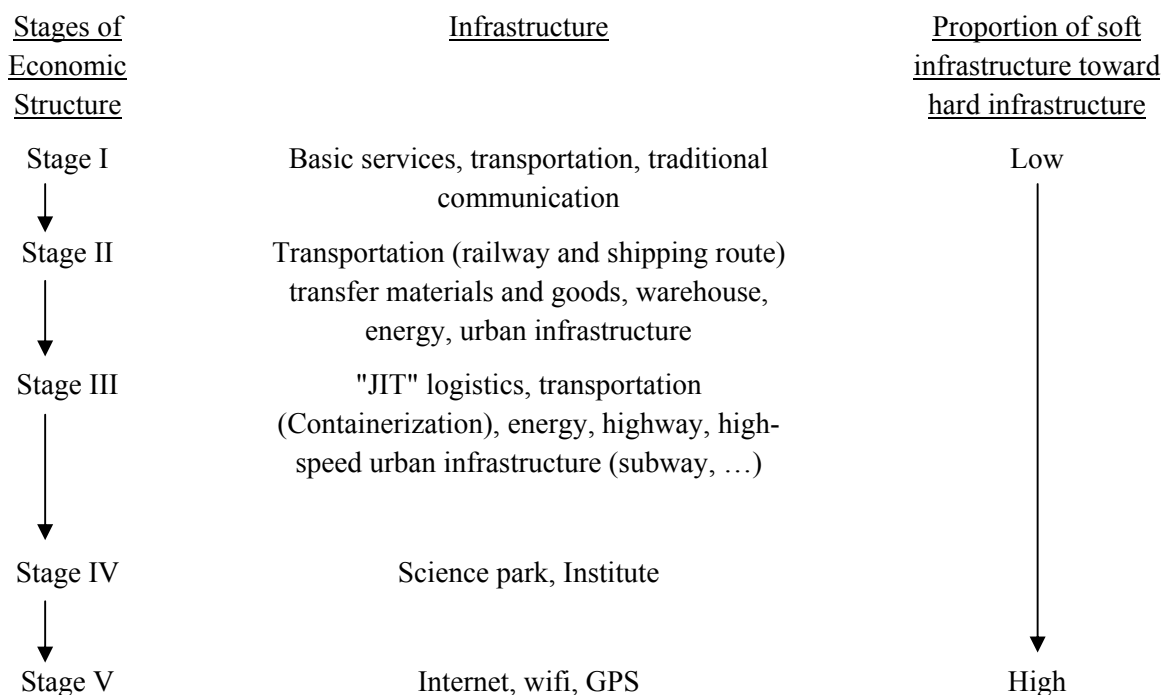
Till now, industrialized-economic structure is diversified into several stages: (1) the economy that led by resource-intensive light industries such as the textile industry that performs labor-intensive production; (2) the economy that led by capital-intensive and large scale heavy industries such as metallurgical industry and chemical industry; (3) the economy that led by capital intensive and modular production industries, such as automobile manufacturing, electronic industry; (4) the economy that led by creative industries, such as IT hardware manufacturing industry; and (5) the economy led by Internet, such as digital content creation industry (Ozawa, 2009).

Meanwhile, three first stages are belonged to manufacturing economy, whereas the other two

stages are belonged to knowledge economy. At higher stages, an economy tends to perform production fragmenting and distributing, including international production fragmentation. Besides, as being in the higher stage as larger proportion of soft infrastructure that facilitates such stage to form up and develop.

Upgrading economic structure means a switching from one stage to next higher stage in that scale. Vietnamese economy now is in the second stage and has initiated components of the third stage. To shift to the third stage – the economy based-upon industries that are capital intensive and apply modular production model, it is must to prepare necessary conditions for that stage. One of such conditions is to develop industrial clusters. Even that the economy is intended to shift to the fourth or the fifth stages, developing industrial clusters is still a key solution.

Developing industrial clusters is also a major solution to relocation production territory and to improve economic effectiveness. Because industrial agglomeration just forms up if it satisfied some appropriate conditions (the availability of industrial parks, infrastructures and other firms, especially anchor firms), an attempt to attract firms to location without appropriate conditions of industrial agglomeration will not be effective. In other hand, if the location that fit with industrial agglomeration is a rich soil area, then the development of industrial cluster must to do a trade-off between developing industry and maintaining agricultural lands. Simultaneously, as mentioned above, industrial clusters as developing to a specific level will become growth pole of one region, and make a spillover effect to other remaining locations in such region and to other regions as well.



**Figure 1. Industrialized-economic structure (Ozawa, 2009).**

## 2.2. Industrial Agglomeration in VietNam

In history, we observed some streets that intensively doing a specific business, specializedly producing a specific product. Today,

we still visit such legacies in ancient quarter in Hanoi.

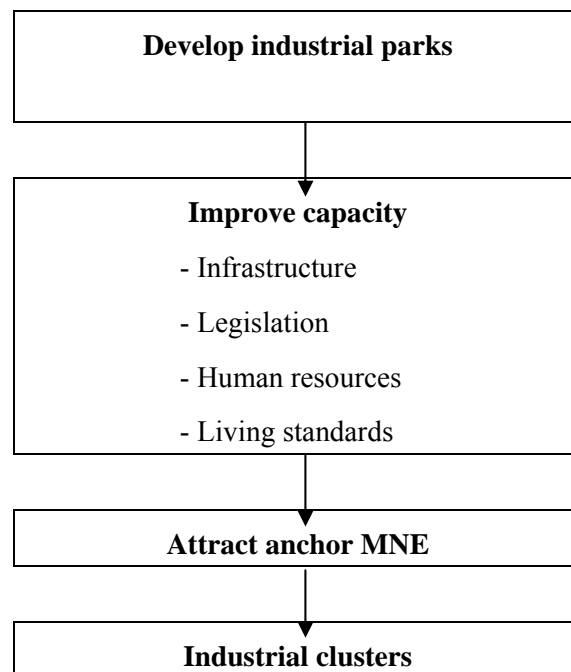
One of JETRO's research revealed that there are evidences of industrial clusters in dealing with automobile manufacturing industry, electronic

appliance and office equipment in Hanoi and neighbourhood; software industry/ICT in Hanoi and HCMC; apparels in HCMC and Hanoi; steel manufacturing industry in Hanoi, HCMC, Danang, Haiphong, Thainguyen; seafood processing industry in Mekong River Delta (Riedel *et al*, 2005). Another research of JETRO showed that there is an industrial agglomeration around Canon in Hanoi and neighbor provinces, around Toyota, Honda and Yamaha in Phuc Yen-Soc Son-Dong Anh-Me Linh. Xuan Kiên – an automobile manufacturer producing Vinaxuki – has three plants located in Dong Anh-Me Linh. Ford Vietnam, GM Vietnam locate closely within the distance lower than 100km. Truong Hai Auto is trying to construct an automobile industrial zone for the company and affiliates in Chu Lai and Dong Nai. In the South, Suzuki in Dong Nai, Mitsubishi in Binh Duong, Isuzu in Go Vap (HCMC) – meaning that are closed to each other. Survey of Truong Thi Chi Binh (2010)

showed that there are 60 firms from Taiwan in Dong Nai province. These firms provide parts for VMEP Ltd. Co. manufacturing motorbikes.

Survey of Truong Thi Binh (2008), Nguyen Binh Giang (2010, 2011), Phi Vinh Tuong (2011) recorded a great number of enterprises located in Hanoi and surrounding provinces as well as HCMC and neighbor provinces eventhough there are a number of infrastructure components not good enough to industrial agglomeration in such locations.

Empirical survey of Dinh Thi Thanh Binh (2009) showed that FDI companies tend to locate in provinces with the appearance of other companies. FDI firms tend to stay near each other but not taking any impacts from domestic firms. Domestic firms are also not impacted by international enterprises in the same industry. FDI firms from a same country tend to locate near each other.



**Figure 2. Kuchiki’s Flowchart (Kuchiki, 2005)**

**Table 1. Number and areas of industrial parks established in Vietnam till the end of 2010 by regions**

Region	Number of industrial parks	Area (hecta)
Red River Delta	66	15031
Northern mountainous region	16	2478

Central Coast	39	9256
Central Highland	8	1261
Southeast	88	33290
Mekong Delta	43	10078
<b>The whole country</b>	<b>260</b>	<b>71394</b>

*Source:* Department of Economic Zones Management (2/2011).

In general, industrial agglomeration occurs in Vietnam in natural way. There are industries or firms that are scattered throughout the country.

### **2.3. Evaluation of Industrial Clustering Policy in Vietnam**

Till now, Vietnam has not any industrial clustering policy. Following analysis will illustrate for the point.

Due to the lack of international level large domestic firms or global competitive domestic firms, attracting foreign investments plays an crucial role toward Vietnamese economy. Therefore, among the four types of industrial clusters mentioned above, the second type should be developed in Vietnam.

To evaluate industrial clustering policy in Vietnam, including both formal and informal types, the research is going to apply the Kuchiki's flowchart (2005). According to Kuchiki (2005), industrial clustering policy of a developing country should follow a flowchart as shown in Figure 1. At first, the country should develop industrial parks and export processing zones. Then, the country should improve its capacity including hard infrastructure (transportation, communication, electricity, water system), soft infrastructure (legislation, administrative apparatus especially checking and licensing agencies, human resources including both common and skilled human resources, and living standards for foreign managers and their family). Thirdly, it should attract FDI of anchor multinational corporations including brand firms, OEM and ODM firm. Lastly, it should promote outsourcing companies, subcontractors and other international and domestic joint ventures to

participate into value chains/production networks leading by top multinational corporations.

Vietnam has been well done in the first step. To the end of 2010, there are 260 industrial parks in the whole country (besides, there are some industrial parks acquired licensing but not yet constructed or having planned but not yet approved).

There are a great number of Vietnamese industrial parks gathering in the North (especially in Hanoi and the surroundings) and the southern key economic regions. Industrial parks concentrate mainly in Dong Nai (28 parks), Binh Duong (27 parks), HCMC and Hanoi (16 parks each city). We can observe the forming of "industrial corridors" along the national highways 1A, 2A, 5, 10, 13, 14, 18A, 22, 51A, etc.

The fact that there are a number of industrial parks, regardless of size of the areas, nearing each other in large urban regions and along the important highways is a good condition to promote industrial clustering policy.

For the second stage, we should study hard infrastructure at first. Vietnam's transportation infrastructure has been invested massively in recent years. Research of JETRO (2008) showed that Vietnam has a big step in road transport infrastructure development. Although there are some complaints about bad traffic situation, but it is about the traffic situation in big cities or in the mountain regions. By the way, in comparing to Thailand, Vietnam's road traffic infrastructure still lags far behind. Whereas almost Vietnamese highways is two-lane roads, standard for state highways in Thailand is four-lane express way. Another bottleneck of Vietnam is that the capacities of two major ports in Haiphong and

HCMC are insufficient. Both two major international airports - Noi Bai and Tan Son Nhat – are overloaded because of small capacity.

Vietnamese communication infrastructure is standing at high rate in ASEAN, just behind Singapore and Malaysia. However, frequent power outages and voltage instability are other threats in Vietnam. Not every industrial park has back-up generator. Clean water for production does not meet international standards is a further obstacle.

General review of JETRO is that Vietnamese hard infrastructure is not good enough to develop industrial clusters (survey of Kuchiki and Gokan in Hà Nội in 2008<sup>1</sup>).

About soft infrastructure, at first, we should review the plans to develop industries.

- In mechanical industry, there are following plans:
  - ✓ Plan on development of Vietnam's Automobile Industry till 2010, vision to 2020. This plan has been issued in 2004 with the Decision No.177/2004/QĐ-TTg.
  - ✓ Plan on development of Vietnam's motorbike industry period 2006-2015, vision to 2020. This plan has been issued in 2007 with the Decision No.002/2007/QĐ-BCT.
  - ✓ Plan on development of prime mover and agricultural machine manufacturing industry for the period 2006-2015, vision to 2020. This plan has been issued in 2008 with the Decision No.02/2008/QĐ-BCT.
- In the footwear industry, there is a master plan on development of footwear industry till 2010. This plan has been issued in 2007 with the Decision No.36/2007/QĐ-BCN.
- In apparel industry, there is a master plan on development of textile industry till 2010. This plan has been issued in 1998 with the Decision No.161/1998/QĐ-TTg.
- The plan on development of industrial support industry till 2010, vision to 2020. This plan has been issued in 2007 with the Decision No. 34/2007/QĐ-BCN.
- For regions and territories, there are following plans:
  - ✓ The master plan on development of Vietnamese industries by regions till 2010, vision to 2020. This plan has been issued in 2006 with the Decision No. 73/2006/QĐ-TTg.
  - ✓ The plan on development of Vietnam's industrial parks till 2015, vision to 2020. This plan has been issued in 2006.
  - ✓ The master plan on socio-economic development in Red River Delta. This plan has been issued in 1997.
  - ✓ The master plan on socio-economic development in Southeast Vietnam. This plan has been issued in 1997, amended in 2012
  - ✓ The master plan on socio-economic development in Mekong Delta till 2020. This plan has been issued in 2012.
  - ✓ The master plan on socio-economic development in Vietnam's Central Highland till 2020. This plan has been issued in 2012.
  - ✓ The master plan on socio-economic development in Northern Key Economic Region for the period of 1996-2010. This plan has been issued in 1997.
  - ✓ The master plan on socio-economic development in Vietnam's Central Key Economic Region till 2010. This plan has been issued in 1997.

The plan on development of separate industry did not mention to geographical location for plants, as well as industrial agglomeration or industrial cluster.

The plans on development of various industries by region, the master plans on socio-economic development for key economic regions have been mentioned only major regions (split the

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<sup>1</sup> Kuchiki (2008).



whole country into 7 regions). The plans did not mention to the smaller region within radial distance of 50 km; the area fits with just-in-time logistics. Besides, zoning plans did not refer to industries. Some industries have been mentioned in various regions. Some zones have too many industries.

The plans on development of industrial parks have just mention which province will add industrial parks or extend which industrial parks with specific areas. The plans did not figured out the industries including.

The plans on development of industrial supporting industry have mentioned some components of industrial cluster policy as follows:

- For textile industry: Building and developing 3 centers of textile materials at Hung Yen, Long An, Binh Duong, and Da Nang.
- For footwear industry: Building center of footwear materials at Ha Tay, Binh Duong, and Quang Nam.
- For automobile industry: Attracting joint-venture to produce diesel engines at Cu Chi's automobile industrial park (HCMC), forming industrial park to support producing engines and automobile at HCMC, Binh Duong, Tay Ninh. Constructing new plant for manufacturing gear for drivetrain system at HCMC or Da Nang.
- For mechanical engineering industry: Building industrial clusters of support mechanical supporting industry at Hanoi, Vinh Phuc, Bac Ninh, Hung Yen, Hai Phong, Dong Nai, Ba Ria-Vung Tau, Binh Duong, Tay Ninh, and Da Nang.

The master plans on socio-economic development in Vietnam's Central Highland, Mekong Delta, Southeast VietNam have some key points of industrial cluster policy with identifying which industries should be focused in each region. For example, Southeast Vietnam is identified as the key area for hi-tech industries in Southeast Asia; Mekong Delta Region is identified as the key area for export-oriented agro-fisheries processing industry, textile and footwear industry, industry of mechanical engineering for agriculture, Vietnam

Central Highland is identified as the key area for agro-forestry product processing industry. According to new plans, Southeast Vietnam is not key area for auto-motobike industries.

For other soft infrastructures, there is a lack of skilled labors (as the interviewing enterprises implemented by Institute of World Economics and Politics, 2010)<sup>1</sup>. There are plenty of unskilled labors. But such labors often quit job or are on strike. Licensing and checking procedures seem outwardly simple and quick, but in fact are slow; bribery and informal relationships are considered conditionally essential as firms implement procedures. About the living conditions for entrepreneurs and labors, it is clearly lack of schools, hospitals, entertainment places, and theft.

Although conditions for the second stage is not satisfied enough, but Vietnam Investment Promotion Policy toward leading MNEs is positive. As the result, the country has attracted a great number of leading companies such as Panasonic, Canon, Samsung, ... If the conditions for the second stage are good enough, the third stage should meet better results.

### 3. RECOMMENDATIONS

Vietnam needs industrial clustering policy in the program of restructuring the economy.

- Restructuring territories, urban regions by narrow functions to provide the basis for development of industrial clusters.
- Planning the development of industrial parks by sectors and sector function of region.
- Planning transportation infrastructure in dealing with the plans for regions, industrial cluster development policy of Vietnam, and special distribution of global production network and industrial clusters of other countries in the region.
- Focusing on international cooperations in building industrial clustering policy, because

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<sup>1</sup> However, interviewing experts of Kuchiki and Gokan in 2008 revealed that number of skilled labors is enough at Hanoi.

many countries support oversea investments of their firms and therefore, are interesting in localization policy of investment-receiving countries.

- Improving infrastructure capacity, institutions, living conditions (conditions of the second stage in Kuchiki's flowchart).
- Building program or white book on development of industrial cluster. The program or white book should mention to the content of program, objectives, solutions and conditions to implement such solutions. It is needed to refer the experiences of Japan, South Korea, and European countries.

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# **INTERNATIONAL CONFERENCE ON ENTERPRISE CHALLENGES: HOW TO OVERCOME ECONOMIC CRISIS**

**September, 2012**

**Hanoi, Vietnam**

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