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**TRADE AND INDUSTRIAL DEVELOPMENT STRATEGIES
FOR THE HA LONG BAY REGION**

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Foreword

The current crisis in Asia has created a severe regional capital shortage, which is particularly acute in Vietnam. At the same time there is excess supply in many important industrial sectors, like cement, steel, shipbuilding, etc.

As a result, it is clear that development plans, first approved in 1996/97 must now be reconsidered. When the plans were first put forward, it seemed that investment resources might unconstrained. Growth was to be strong and demand was expected to rise much faster than supply in most sectors. Foreign investors and official lenders were keen to get exposure to Vietnam.

Two years later, things are radically different. Foreign investors have stopped coming and official lenders no longer have the same resources available, or if they do they are apt to use them to pursue economic domestic agendas over Vietnam's. As a result, it is imperative that present Vietnamese development strategies are revisited in order to develop a set of realistic policies with attainable goals.

Vietnamese responses to date have been mostly administrative. There has been no general shift in strategy in order to adapt to current conditions. As a result, provinces like Quang Ninh, indicate that they will be slowing down implementation of previous plans rather than revisit the basic assumptions that gave birth to those plans. This kind of response will waste scarce time and resources and will prove to be a terrible mistake.

Poor lending and investment practices are at the heart of the problem in Vietnam. From official lenders, to the central and provincial governments, to the financial system, incentives are skewed to select bad investment projects and misallocated scarce resources to non-economic, inefficient sectors. If government policy continues to support an import-substituting, heavy industry strategy, then the future may not be bright. There are at least several years of excess capacity in heavy industrial products, both domestically and in the region.

There are obvious contradictions that need to be dealt with. Current policies will tend to exacerbate rather than ease foreign exchange shortages for the next few years. In order to support current policies, the government will have to pursue a set of trade restricting policies. This, at a time when Vietnam is committed to reducing trade barriers.

However, if the government, at the provincial and central levels, takes advantage of the current opportunity to stop bad projects and redirect energies into more productive areas, then the situation need not be as bleak. This will require a wholesale reworking of present development strategies.

Making such a strong break with the past will not be easy however. There are important domestic political interests at stake and weaning them from their current ways will take not only sound economic policies, but also strong political will.

Executive Summary

Development of industry and trade in the Hai Phong/Quang Ninh area is a mixed picture. On the one hand, provincial authorities have expressed preferences for investing in developing large-scale heavy industries. In the current period of constrained resources, making the preferred industrial development plans of both provinces a reality is a remote possibility.

Even if it were possible to actually finance and develop the projects that the local authorities in the study area are promoting, benefits in terms of employment, exports, and competitiveness associated with the preferred strategy are limited. The preferred industrial development strategy by definition employs few people, does not export and will find it difficult to compete at international prices.

On the other hand, the picture in both provinces is not entirely bleak. Both provinces have dynamic sectors that are responsible for providing economic growth, exports and jobs to a growing sector of the population. In Hai Phong, the shoe and garment industry, particularly the private sector, has been growing rapidly in spite of the regional downturn. In Quang Ninh, border trade with China through Mong Cai has been the dynamic sector.

A realistic industrial development strategy will be one that builds on the dynamism in the economy not one that attempts to develop in spite of it. Over the medium term that means Hai Phong should support and promote the continued development of private sector manufacturing through improving access to credit and reducing bureaucratic obstacles to the rapid development of a corporate private sector. Quang Ninh should actively promote its trade based ties to China and find ways to lower trade and investment barriers between China and Vietnam. This will include infrastructure (road) upgrades between Mong Cai and Ha Long.

In both cases, there is a strong argument to be made for aggressive tourism marketing efforts, though each with a different target consumer. Hai Phong will likely do better with Vietnamese tourists, while Quang Ninh is in a better position to capture the Chinese tourists.

A strategic approach to industrial development in the study area might look something like the following:

- 1) Hai Phong continues to play the central role as provider of transport and port services throughout the North. Continued development of the private sector leads to growth of light industry for export, particularly in shoes and garments. "Special Economic Zone" status may promote further development of light industry and the private sector. Local government and foreign sector focus on upgrading port facilities in order to support growing demand. Improved transportation links between Hai Phong/Do Son and Cat Ba Island increase the potential for tourism in Ha Long Bay.
- 2) Dong Trieu/Uong Bi will take advantage of organic growth along Route 5. Upgrading connections between this area and the Rte. 5 corridor will create opportunities to develop light industry. Upgrading infrastructure connections

between Dong Trieu/Uong Bi and Rte 5 will bring this area into the economic life and activity of the northern Red River Delta.

- 3) Mong Cai on the Chinese border will continue to play a very important role in developing trade with China. Mong Cai can take advantage of its beach areas in order to expand possibilities as a destination for Chinese tourism. Once Mong Cai gets "Free Trade Status" in a 15km radius of Mong Cai town, then Mong Cai will develop processing industries, based upon Chinese and domestic investment, for export to China and beyond.
- 4) Cam Pha will continue to be dominated by coal and the coal-related sectors for the near future. The coal sector will add little to Quang Ninh's future incremental growth. In employment terms, the coal sector will lose jobs as it seeks to become more efficient and competitive. Unemployment will become an increasingly important issue in this region.
- 5) Ba Che/Tien Yen/Quang Ha are among the poorest districts in Quang Ninh Province with high percentages of minority peoples. There are opportunities to raise income through tea growing, but suitable land is limited. Economic and industrial development in these areas will require special attention from local and central government.
- 6) Ha Long City will not become a major destination for light or heavy industries. Port services will not play an important role in incremental growth. Rather, Ha Long Town will find itself relying exclusively on tourism and services for future growth. Rapid development of the tourism sector will be necessary in order to absorb redundant employment from Vinacoal. In tourism, Ha Long can focus its tourism services in order to cater to Chinese tourists. In other tourist markets, Ha Long will have to increasingly compete with Hai Phong for tourists. Ha Long may benefit from some of Mong Cai's tourism and trade success if Quang Ninh completes an upgrade of Rte18A between Ha Long and Mong Cai.

Study Area

The study area for this review consists in the most general terms of the Ha Long Bay area. The Ha Long Bay area includes specifically Hai Phong and Ha Long Town as they border directly on the bay. The study area also includes the adjacent areas of Dong Trieu, Uong and Cam Pha as they are contiguous areas of Hai Phong and Ha Long and development in those areas may have some effect on the bay itself.

The study area was grouped together with Hanoi in the early 1990's into a "Northern Growth Triangle". The government hopes to promote industrial development inside of this geographic area. The triangle runs along Rte. 5 from Hanoi to Hai Phong, then along Rte. 10 from Hai Phong to Ha Long and finally along the proposed Rte.18 from Ha Long to Hanoi. Industrial growth along Rte. 5 has been rapid in recent years. Such success has not yet been repeated along Rte. 10 and the proposed Rte 18.

	STUDY AREA	OF ALL VIETNAM
Population	2,645,445	3.45%
GDP (billion dong in 1994 prices)	9,628	4.34%
<i>Of which:</i>		
Agr/for and fishery	1,405	2.51%
Industry and construction	3,619	4.92%
Service	4,604	4.98%

Source: GSB 1997

During the course of the study, the study team made a determination to include the border town of Mong Cai in the study area. While there is no direct connection between Mong Cai and Ha Long Bay (distance 200km), the study team has determined that Mong Cai will play a critical role in the economic and industrial development of Quang Ninh Province. As such, Mong Cai will have an indirect impact on the Bay and is therefore included in the study area.

It is important to note that the study area consists of two provinces located in two different economic regions. Economic development options in these two provinces do not seem to have any direct linkages. Certainly from an administrative and local perspective, these two areas are very distinct.

Hai Phong is located in the Red River Delta and as such it has easy access to other provinces in the delta and has long-standing connections to the national economy. Hai Phong is a large urban area with developed infrastructure and serves as the main port for the northern part of Vietnam. While local authorities would like to invest heavily to develop heavy industry, Hai Phong is (relatively speaking) outward-oriented and has an increasingly dynamic private sector focused on developing the exportable sports shoe market.

Quang Ninh, on the other hand, is an 'old company town' with little private sector activity and strong planning tendencies. Economic activity in the province is dominated by the centrally-owned VINACOAL Corporation. Local authorities are

convinced that their future success depends on the development of heavy industry, specifically coal, cement and steel. Light industry does not play a role in provincial economic planning. The Northeast region, where Quang Ninh is located, has few direct connections to the economic life in the Red River Delta, but has a rapidly growing connection to China.

This paper will not attempt to reconcile the differences between the two provinces. Rather, it will present contrasting stories of two different development directions. One direction is outward-oriented trade focused and will rely heavily on a dynamic light industrial sector (with lots of domestic private sector and foreign investment). The other shows a heavy planning orientation with a fixation on heavy industry and a lack of interest or a disdain for light industry and the private sector.

One of these development directions may lead to rapid sustainable economic growth, the other almost certainly will not.

Box: Northern Economic Development Triangle

The Northern Economic Development Triangle is a 15,000 sq. km area. The triangle runs along Rte. 5 from Hanoi to Hai Phong, then along Rte. 10 from Hai Phong to Ha Long and finally along the proposed Rte.18 from Ha Long to Hanoi. The government of Vietnam has identified four major areas of economic potential within the triangle:

- 1) Extraction and processing of mineral resources (coal, iron ore, apatite and limestone);
- 2) Heavy industry (chemicals, steel, cement, fertilizer, ports, and machinery);
- 3) Light industry (textiles, plastics and food processing);
- 4) Expansion of existing labor-intensive export industry (garments, shoes, leather);

The government has determined that inadequate infrastructure and infrastructure bottlenecks within the assigned triangle severely constrain growth potential. The government has determined that major investment in new road construction, industrial zones and port development will assist the growth triangle meet its development objectives.

Government identified priorities for the Northern Economic Development Triangle in the short to medium term are:

- 1) Modernize existing plants in heavy and light industry and food processing (Domestic finance);
- 2) Increase access to FDI and ODA;
- 3) Develop capacity in export-oriented light industry (Domestic and foreign finance);
- 4) Develop labor intensive electronic component manufacturing (Domestics and foreign finance);
- 5) Cement plant development (Government finance);
- 6) Ship-dismantling for scrap steel.

The government has identified the North for potential to become the center for the engineering and machinery industry in Vietnam.

Hai Phong

Hai Phong has traditionally been regarded as the industrial and economic heart of northern Vietnam. It is here where traditionally planners have sited heavy industry: cement, steel and shipping. Growth during the 1990's has been rapid. Industrial growth has averaged over 17% (per annum) since 1991.

In recent years, Hai Phong has been undergoing something of a transformation. While there are still big plans for heavy industry in Hai Phong, these industries are running into hard times. The foreign sector has invested heavily in cement and steel,

Growth Rates Of GDP (%) in Hai Phong

	1991	1992	1993	1994	1995	1996	1997	1998 (est.)
GDP	5.6%	12.0%	14.1%	13.9%	15.0%	9.6%	9.7%	7.7%
Agriculture, fishery	-4.6%	17.4%	13.3%	7.3%	8.0%	7.4%	5.4%	2.4%
Industry, construction	3.6%	13.5%	28.0%	23.5%	17.2%	11.3%	25.1%	14.5%
Service	10.5%	9.6%	8.7%	11.8%	16.4%	9.5%	2.7%	5.0%

but rapid supply growth on the domestic market and imports are forcing these firms to compete at closer to international prices. Medium term prospects for expanding this sector are not bright.

Port services remain an important source of government employment.¹ The Hai Phong Port is also a major source of revenue for the city and is a major contributor to provincial GDP (services). This reflects the traditional position of Hai Phong as the central provider of port services to northern Vietnam.

Hai Phong GDP Composition
(Bill Dong 1994 price)

	1990	1991	1992	1993	1994	1995	1996	1997	1998 (est.)
GDP	3,004	3,172	3,552	4,054	4,618	5,311	5,822	6,386	6,881
Agriculture, fishery	652	622	729	826	887	957	1,028	1,083	1,110
Industry, construction	701	726	824	1,055	1,303	1,527	1,699	2,126	2,434
Service	1,651	1,824	1,999	2,173	2,429	2,827	3,095	3,177	3,338

Heavy industry and port services are important parts of Hai Phong's past. The question that needs to be asked is will they be part of Hai Phong's future. There is a very strong argument to be made that, plans aside, the market is in the process of deciding Hai Phong's future.

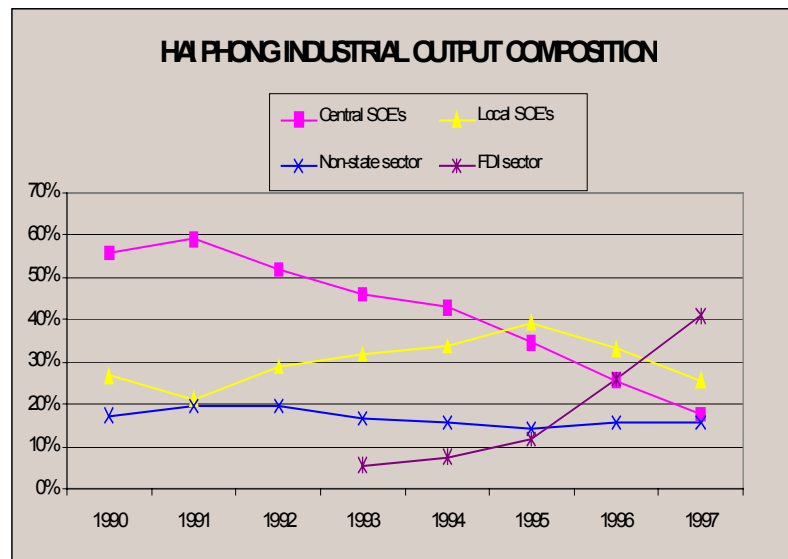
¹ Port services are the responsibility of the central government.

Share Of Hai Phong GDP By Sectors

	1990	1991	1992	1993	1994	1995	1996	1997	1998 (est.)
Agriculture, fishery	22%	20%	21%	20%	19%	18%	18%	17%	16%
Industry, construction	23%	23%	23%	26%	28%	29%	29%	33%	35%
Service	55%	58%	56%	54%	53%	53%	53%	50%	49%

The most dynamic sector in the city is the export shoe industry and garments. These two sectors have been growing quickly in the past three years and are now the number one and number two industrial employers in Hai Phong. These two sectors have fared relatively well recently as they rely on export markets in Europe, though buyers tend to be Asian. These sectors tend to be dominated by the local state and private sectors. Central government SOE's are completely absent from light industry in Hai Phong.

Just as dramatic are the relative decline of centrally-run SOE's and the substitution of the FDI sector for central SOE's. In the past few years, output from the Hai Phong Cement Plant has declined rapidly while at the same time, FDI projects in cement and steel have started to come on line.² Directly as a result, FDI now makes up nearly 50% of the industrial output of Hai Phong.



Foreign investors have been most active heavy industry, in particular cement and steel, where they now are responsible for between 68%-88% of output. While the foreign sector now plays a central role in industrial output, the capital-intensive nature of the investments has important employment impacts.

While accounting for nearly 50% of industrial output, the foreign sector provides for less than 10% of all industrial employment. Modern heavy industry (cement and steel) is increasingly automatized in order to increase efficiency and quality of production. The result is that industries that were responsible for absorbing a large amount of employment are laying-off workers. When the Hai Phong Cement Plant is

² MOSTE listed the Hai Phong Cement Plant as the single biggest polluter in the entire country. It has been scheduled to be shut-down and replaced with a modern plant by the year 2003.

closed, it will be replaced with a plant that requires only 10% of its current 3,300 man strong labor force in order to produce four times the capacity of cement.³

In employment terms, the most important sector during the 1990's has been the non-state sector. Despite its relatively low share of industrial output, it provides more than 45% of industrial employment. More important, it is the private (non-state) sector that is providing new employment. The state sector (central and local) has over the past three years been unable to keep pace with employment growth in the private sector. The non-state and local SOE sector have focused almost entirely on export-oriented light industry.

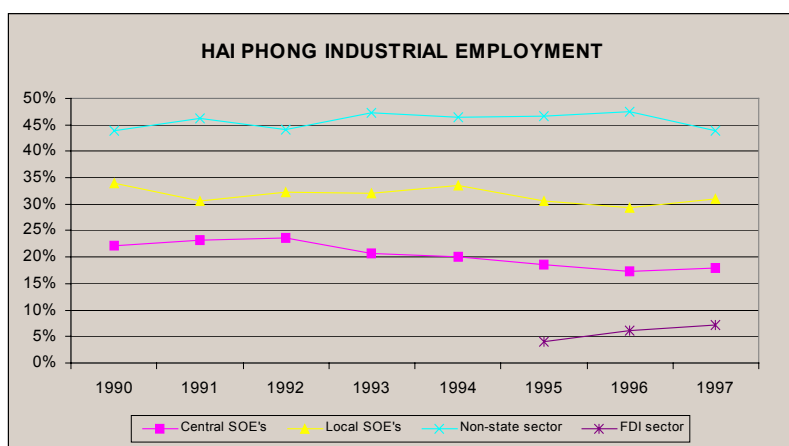


Table: Hai Phong Major Industrial Products (see appendix)

Import-export activity of Hai Phong also reflects the recent growth in importance of light industry. Hai Phong's largest single export good and foreign exchange earner is 'sports shoes.' This sector is responsible for almost half of all of Hai Phong's annual exports.

Hai Phong Exports and Imports
Million US\$

	91	92	93	94	95	96	97
Exports	25.2	34.0	32.2	76.9	120.7	163.3	208.1
Imports	8.6	17.5	45.8	116.5	347.4	396.5	Unk.

In terms of government revenues, the two largest sources of Hai Phong's annual budget are the foreign sector (19%) and trade taxes (51%). This distribution reflects the importance of trade and port services to the local economy and the recent rapid growth of output in the foreign sector. Local SOE's and private sector businesses, despite their recent growth, have not seen that translate into a higher proportion of tax collections in those sectors.

³ Labor force will be reduced from 3,300 to about 300. Most workers at the new plant will be new hires. Existing workers will be let go or retired.

TOTAL REVENUES COLLECTED IN HAIPHONG
(for both Central & Local Budget)

million
VND

Sources	1990	1991	1992	1993	1994	1995	1996	1997
Central SOEs	37,350	90,285	142,214	171,721	214,816	264,000	271,485	252,952
Local SOEs	12,012	18,655	29,603	60,019	98,141	145,000	188,089	184,986
Private	13,611	16,118	32,857	55,946	83,314	101,000	91,554	99,510
Agriculture	6,159	12,232	25,442	27,458	21,276	27,000	33,406	28,589
Custom	88,344	85,741	236,998	770,815	1,305,589	2,342,000	1,758,386	1,276,681
Others	19,181	26,496	38,328	148,253	210,569	304,581	400,922	435,120
Total	176,657	249,527	505,442	1,234,212	1,933,705	3,183,581	2,743,842	2,277,838

Table 4: SHARE OF REVENUE CONTRIBUTION BY SECTORS
(for both Central & Local)

%

Sources	1990	1991	1992	1993	1994	1995	1996	1997
Central SOEs	21%	36%	28%	14%	11%	8%	10%	11%
Local SOEs	7%	7%	6%	5%	5%	5%	7%	8%
Private	8%	6%	7%	5%	4%	3%	3%	4%
Agriculture	3%	5%	5%	2%	1%	1%	1%	1%
Customs	50%	34%	47%	62%	68%	74%	64%	56%
Others	11%	11%	8%	12%	11%	10%	15%	19%
Total	100%	100%	100%	100%	100%	100%	100%	100%

As most of Hai Phong's foreign investors tend to be Asian, the Asian crisis has taken a toll on the FDI sector. Hai Phong has registered only \$8 million in new projects this year and has others postponed or cancelled because of the crisis. The majority of Hai Phong's foreign investment is in heavy industry. Most of the city's heavy industry plans are now on hold due to market difficulties.

Light industry has been negatively affected, but on the whole continues to post impressive growth figures, however. The crisis may provide an opportunity for Hai Phong to rethink its focus on heavy industry, which has not been profitable, and to focus on those sectors (light industry) that have provided the most rapid growth and employment.

Hai Phong Development Strategy

The master plan for economic and social development of Hai Phong recognizes the importance of the growth corridor concept⁴ in the overall development of the city. Hai Phong has assessed its comparative advantage and has decided on a two pronged approach to its development including industry and trade.

In order to develop industry, the city has outlined seven priority areas for investment. These can be loosely grouped as light and heavy industry. In the light industry category, the city has focused on shoes, garments, electronics/IT and food/fish processing. In heavy industries, Hai Phong has focused on areas where they have been traditionally important, including cement, shipbuilding, steel, and chemicals.

⁴ It is worth noting that the Hai Phong Masterplan recognises the importance of a 'Hanoi-Hai Phong' corridor, not a triangle including Quang Ninh.

The city hopes to raise cement production to 4 million tons per year by 2010 and steel production to 1.5 million tons by 2010. Industrial zones are expected to play a central role in the geographic distribution of industry.

The second important development leg for Hai Phong is trade and tourism Hai Phong hopes to increase its ability to act as the Red River's gateway to the world. This means continued focus on port and transport activities for Red River Delta provinces, and as far south as Thanh Hoa.

In addition, Hai Phong hopes to develop the Hanoi-Hai Phong/Cat Ba-Ha Long tourist route from Do Son. Tourism is still small and limited mainly to day-trippers from Hanoi and foreign tourists on their way to or from Ha Long. Local authorities hope that a mix of state and private sector domestic tour agents will develop additional tourism business.

Project	Value	Description
New Channel Dredging	\$80,000,000	Dredge new channel approach to port
Rte 12 Upgrade	\$33,000,000	Upgrade to support export processing and tourism
Cat Ba Road	\$6,000,000	Upgrade to support tourism
Cat Bi Airport Upgrade	\$50,000,000	Upgrade to back-up status for Noi Bai Airport
Infrastructure for Nga Nam-Cat Bi Urban area	\$81,000,000	Infrastructure to support urban development
Ho Sen Road	\$11,000,000	New urban area
Opera House Upgrade	\$8,000,000	
An Bien Park	\$16,000,000	Public benefit
Water Treatment Plant	\$20,000,000	Support urban development
Urban Sewage System	\$30,000,000	Support urban development
Garbage Treatment Plant	\$15,000,000	Support urban development
Electric Power Plant	\$350,000,000	300MW Coal-fired plant
International Hospital	\$15,000,000	High quality health care
Real Estate Development	\$45,900,000	New urban area
Hang Kenh Urban Area	\$50,000,000	New urban area
Upgrade Nam Phap Road	\$18,000,000	New urban area
Tile Factory	\$1,200,000	Construction materials
Park	\$10,000,000	Park for urban poor
Total	\$840,100,000	

Industry

It should be noted that except in the FDI sector and in garment and shoes industries, the rest of Hai Phong industry still suffers from years of under-investment and is noncompetitive. Most firms are equipped with very old technology and obsolete equipment. Their products can hardly compete against similar products from China or the South. This is especially true in bicycles, electric appliances, plastics, and construction materials. Outside of shoes and garments Hai Phong has almost no manufactured exports.

Light Industry

The most important of the new light industries is the shoe industry. This industry has emerged in the 1990's and holds promise for future growth. In less than 10 years, the industry went from being negligible to the city's biggest employer and foreign exchange earner.

Production increased from a half million pairs in the late 1980s to more than 22 million pairs in 1997, while employment rose from about 1% to over 20% of the industrial labor force during the same period. The industry is currently the most important employer in the city with close to 30,000 jobs, 15,000 of these jobs in the private sector. Output and exports in the shoe industry have been rising rapidly. Output in 1994 was 600 million Dong. This jumped to 1,314 billion Dong in 1997.⁵

Unlike more traditional heavy industries, the shoe for export business is much less capital intensive, has relatively low barriers to entry and is extremely competitive. Local SOE's are the dominant players in this sector, but the private sector has shown robust growth over the past three years. This growth trend looks set to continue with the rapid expansion in business of the Dinh Vang (private) and SHOLEGA (Hai Phong) enterprises.

Lack of access to traditional financing avenues has not stopped the development of these enterprises. Where shoemakers have been able to develop relationships with customers they are able to work out delayed payment terms for equipment and machinery required in the production process.

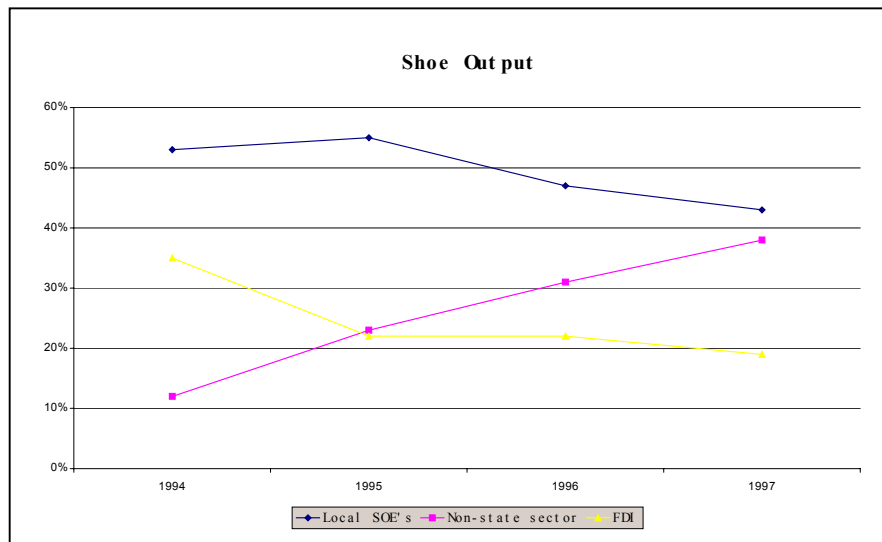
Hai Phong - EXPORT SHOE INDUSTRY				
Shoe production Output	1994 Price in millions of VND			
	1994	1995	1996	1997
Total	602,769	710,966 18%	910,463 28%	1,314,317 44%
Local	299,803	390,088 30%	426,801 9%	564,931 32%
Private	58,189	164,472 183%	285,093 73%	499,496 75%
Foreign	244,777	156,406 -36%	198,569 27%	249,890 26%

The shoe industry in Hai Phong is entirely a local affair. There are no central government enterprises active in shoe production in the city. In the early years, the export shoe manufacturing was monopolized by local state-owned enterprises. But by 1997, as the private sector began to develop in Hai Phong, its percentage of

⁵ 1994 prices.

production grew from zero to 38% of the total. Local SOEs accounted for 43%, and foreign invested enterprises 19% of the total output of the industry.

To date the shoe sector seems to be the most resilient sector in Hai Phong's economy. While it has suffered a noticeable downturn, during the current Asian difficulties, it remains the most buoyant of Hai Phong's industries. Despite difficulties related to the Asian Crisis, the shoe sector expects to post 6% export growth this year. Dynamism and good management enable the industry to weather tougher competition from the region, while other industries severely cut production and lay off workers.



Textiles and garments are second in importance in the light industry category with 6,000 employees. This sector has seen rapid growth recently, but has been hit hard in the last eighteen months. This is particularly true of private sector businesses in garments. Unlike the shoe industry, the garment industry is segmented into quota and non-quota markets. Private sector firms tend not to get access to quota markets⁶ and have to depend primarily on non-quota based markets in Eastern Europe and Japan. The Asian crisis has hit the non-quota market particularly hard. Exports to Russia have been temporarily halted and orders from Japanese buyers are down. That said, private sector garment manufacturers report that customers are still placing orders and their main constraint is financing for expansion, rather than lack of orders.

Electronics and IT round out the list of light industries that Hai Phong is focusing on. It is unclear why the city should continue to focus on electronics (radio/TV/computer). Output in this sector has collapsed in the past three years (*see Major Industrial Products Chart*). Local authorities admit that it is unlikely that any investments in this sector will be profitable, however they feel it is important to pursue them nonetheless.

Local authorities have also yet to define the 'IT' industry but are aware that whatever 'IT' is, it is important and deserves attention. While Vietnam has great potential in the 'IT' sector, Hai Phong may not be able to develop much in that regard. While computers

⁶ These quota tend to go to SOE's. The foreign invested sector is prohibited from getting garment export quota.

are common, networking service companies do not yet exist. There is no university or technical college where personnel can get adequate programming training. Most important, businesses and organizations have not yet developed any level of sophistication in their own use of information technology that might create the kernel of demand for a local 'IT' industry. For example, the Office of Statistics of Hai Phong still hand-writes annual and monthly statistics reports rather than assemble them using a simple spreadsheet application.

Priority light industry is being financed by the local sector and through suppliers' credits from foreign buyers. Garments and shoes have strong potential in export markets and will likely to continue to provide industrial growth.

Heavy Industry

Heavy industry in Hai Phong consists of construction materials, steel, and shipbuilding. Two cement plants represent the whole of the construction materials sector in Hai Phong. The Chin Fong plant (1.4 million tons/year) came on line last year. The second phase (2.7 million tons) of this project is doubtful in current conditions. The second plant is the Hai Phong Cement Plant. This plant, located downtown, is in the process of moving to a location north of the city. Financing delays have pushed off the opening of the new plant (1.4 million-tons/year) until at least the year 2003.

Incremental investment in cement does not appear to be sound investment and there are indications from the foreign investor, despite encouragement from local authorities that they will not go forward with the second phase.

The steel industry currently has three joint ventures (Vinausteel, Vinapipe and VPS) with a total capacity of 438,00 tons of steel per year and 45,000 tons of steel pipe. All three of these ventures are currently losing money. At the same time, the local authorities would like to attract foreign investors to develop 1,000,000 tons of additional steel making capacity. Given the recent experience of the current investors and the current economic environment, it is unlikely that anyone will be interested in providing capital for this investment.

Utilization of existing steel capacity in Vietnam is already low. Demand for steel in Vietnam in 1997 was 2 million tons. Of this the domestic sector supplied 950,000 tons of the market last year. The rest (1.3 million tons) was imported from the former Soviet Union.⁷ Total installed capacity for steel production was 1.67 million tons per year implying a utilization ratio of only 56% for existing domestic capacity. The situation this year in the steel market is worse. Stockpiles are now equal to 26% of last year's entire production and output is falling rapidly.

Shipbuilding has been identified as a priority industrial area. This reflects Hai Phong's traditional strength in this sector. Hai Phong already has the capability to building ships up to 6,000dwt, but would like to be able to supply ships up to 10,000dwt. While there may be a limited market for supplying domestic tonnage,

⁷ Officials in the steel sector complain that steel producers in the former Soviet Union are dumping their product on Vietnamese markets at below cost.

export markets for tonnage will be extremely limited. Chinese, Korean, and Japanese shipyards are all reported to have excess capacity. Chinese shipyards, in particular, will be very competitive on regional markets in the same class ships as identified by Hai Phong authorities. It is also likely that a local shipbuilding industry will continue to require non-tariff trade barriers in order to keep it competitive in the domestic market.⁸ Because of the current market difficulties in the ship repair/construction industry, the foreign partner (Finnish) in the Pha Rung Shipyard (Hai Phong) has withdrawn. The shipyard is in financial difficulty and has trouble finding markets and customers.

In Hai Phong's favor, the city is looking for foreign investment in order to pursue heavy industry rather than attempt to finance poor investments entirely they. In current conditions, they will not be able to attract investment in their high priority heavy industry areas. In the medium term (2-4 years), regional and perhaps domestic over-capacity is likely to persist. If foreign exchange shortages also continue, it would be self-destructive to continue investments that use scarce foreign exchange and generate almost no jobs. Debt repayments alone, unlikely to be covered by the firms, may be equal to the direct cost of displaced imports for many of these products.⁹

Outside of the priority investment area, the city has a number of other investments in heavy industry that it has decided not to aggressively pursue at this point in time. These include an automobile assembly plant, and an oil refinery.¹⁰

Private Sector in Industry

The private sector has, in the past three years, begun to grow rapidly. This is thanks to the development of the shoe export industry. Local authorities in Hai Phong have begun to recognize the importance of the private sector in generating economic growth and employment opportunities.

It is instructive to examine the contribution of the private sector to recent growth in Hai Phong. The private sector has developed rapidly in the sports shoe export business. Employment has risen from almost nothing to 15,000 employees in the past three years. The private sector is also quick to search out new markets and goods, having entered the soccer ball export market in the past two years. Export values for the private sector industry have also risen quickly, from 58 billion Dong in 1994 to 500 billion Dong in 1997. Continued growth prospects look encouraging, despite the Asian crisis. Shoe exports this year will be up approximately 6%, despite the crisis.

At the same time, the centrally-owned SOE's in Hai Phong have fared poorly reducing production and exports every year since 1995.

⁸ It may be premature to consider expanding shipbuilding activities. The Bach Dang Shipbuilding Enterprise reports difficulty in completing a 6,500dwt vessel because of an inability to get access to \$285,000 in working capital through the financial system.

⁹ Thereby eliminating the foreign exchange rationale for import substitution.

¹⁰ In all scenarios, licensing and management oil refineries will fall under the jurisdiction of PetroVietnam and the Office of the Government, and not local governments.

Employment Growth

Sector	1996-97	1998 (9 months)
State enterprises	5,901	305
Non-state sector	14,608	4,250
FDI	15,919	1,120
Household sector	19,047	9,054
Construction	-	3,115
Enterprise projects	-	4,666

The private sector has played an important role in the generation of new jobs in Hai Phong. The People's Committee of Hai Phong has recognised the importance of the private sector in job generation. During the two years 1996-1997 Hai Phong generated 55,470 jobs, 30,000 of these in the private sector. In 1998 the private sector was responsible for nearly all job creation. During the first eight months of 1998, the corporate private sector created 4,250 jobs and the household sector created 9,054 jobs while the entire state sector was responsible for creating only 305 jobs.

This success of the private sector is in spite of the difficulties that entrepreneurs still face. Most obvious of the anti-private sector regulations are regulations that require collateral for bank lending by the private sector. In many cases, private sector businesses do not have adequate paperwork on their assets and as a result cannot mortgage them. When they are able to mortgage their assets, they are limited to no more than 70% of the value of fixed assets.¹¹ Average assets of a private sector business in Hai Phong are 500 million Dong, implicitly leaving them with a maximum credit line of 350 million Dong (\$25,000). Banks are also not allowed to grant loans for working capital, but are limited to short term project loans. State enterprises, on the other hand are not required to put up any collateral for borrowing and as a result, their implicit borrowing limits are much higher. At the same time, state enterprises can get access to state credits for working capital.

In addition to a poor regulatory framework, the private sector still faces discrimination at many levels that has been described as 'criminalization of the private sector.' The 'criminalization' refers to an attitude by some government officials that private sector businessmen have necessarily broken some law in order to acquire wealth. If they hadn't broken the law, how could they be rich, the argument goes. It is not unheard of, still, for a successful private sector businessperson to have all of his assets confiscated and then be jailed for essentially running a successful business enterprise.

In the face of these difficulties the private sector is still growing. While private sector firms have not been able to get access to credit through the official financial institutions, they have been able to access finance through their customers. Firms establish co-operative relationships with customers that resemble an informal leasing arrangement. This kind of arrangement is very common in the garment and shoe

¹¹ The only collateral banks will generally accept is real estate. Since the real estate market went into a slump in 1996, increasingly banks are only willing to accept cash as collateral. Typically banks in Vietnam do not consider capital equipment (trucks, machinery, etc.) a 'fixed' asset for collateral purposes. One obvious exception is a private firm in Hai Phong that was able to purchase two vans with financing from a private commercial bank. In that case the firm, with the assistance of the local Union for Non-State Enterprises was able to put of the vans themselves as collateral.

industry. The customers supply necessary capital equipment and the firm finances the equipment by reducing its product prices by an agreed percentage.

Access to credit, in the form of customer-firm leasing arrangements is one of the reasons why Hai Phong's private sector has grown quickly in shoe and garments.

A second important reason for their growth is the implicit support they have received from local government and informal networks. The Council of Non-State Enterprises in Hai Phong (COHASHIP) is an aggressive advocate of the rights of private sector businesses. Typically, organizations of this type see their role as 'manager' of non-state businesses on behalf of the government (for example in Quang Ninh). However, COHASHIP has established itself as an active membership organization more akin to a Chamber of Commerce. Its services for its members include training programs, organizing marketing campaigns, and credit assistance. With informal access to credit and a strong advocate, the private sector has been able to grow.

Private sector growth and job creation would be faster still, if there were better access by private firms to credit. An important first step might be applying the same credit rules used for State-owned enterprises to private sector businesses. If policies were adopted that helped jumpstart leasing, then private sector firms might be able to better access credit through leasing activities.

Trade and Tourism

The second important development leg for Hai Phong is trade and tourism Hai Phong hopes to increase its ability to act as the Red River's gateway to the world. This means continued focus on port and transport activities for Red River Delta provinces and as far south as Thanh Hoa.

Hai Phong plans to continue to develop its port capacity. Hai Phong port is now the main international gateway for North Vietnam. Currently the port throughput is over 5 million tons with revenue of 50,000 dong per ton. Employment in the port has been stable at over 5,000 for last few years. Businesses in the city enjoy advantages from being closer to the port. For production of relatively low value-added goods, proximity to the port means significant cost savings.

However, future prospects for the development of port related activities is not high. Containerization is moving many port-related services away from the city. The hope of becoming a transit point for Yunnan and Guangxi in China may not be realistic given the new and very good transportation system connecting these areas to the port city of Beihai in China.

An increasing share of foreign vessels calling at the port also means a decline in demand for Hai Phong's ship repair services. Foreign shipping lines require quick and high quality service which current repair facilities in Hai Phong cannot provide.

Tourism is still small and limited mainly to day-trippers from Hanoi and foreign tourists on their way to or from Ha Long. In 1997, Hai Phong had more than 406,000 tourists. All but 11,000 were beach visitors spending only the day in Hai Phong. The

main destination point for day trips in Hai Phong is Do Son beach. For visitors who stayed in Hai Phong for the night, they tended to stay only 1.8 nights in Hotels before travelling onwards to Ha Long Bay or returning to Hanoi. Average revenue per visitor in 1997 was only 178,000 Dong.

Tourism prospects are looking brighter for 1998, however. The completion of the Rte 5 upgrade (lowering travel time between Hanoi and Hai Phong to less than two hours) is expected to bring greater numbers of domestic tourists to Do Son Beach. Initially, they will mostly be day-trippers, but local authorities hope to take advantage of the relatively short distance between Hai Phong and Ha Long Bay and encourage more tourists to visit Ha Long from Do Son, thereby creating demand hotels and restaurants and boosting per visitor revenues. The study team met with an aggressive private entrepreneur in Hai Phong with plans to begin a high volume Ha Long Bay tour business out of Do Son.

Foreign Direct Investment

Foreign investment has quickly become an important source of financing heavy industry development in Hai Phong. Before the onset of the Asian crisis, FDI accounted for half of the total investment in the city (1996: 50% and 1997: 55%). In less than 5 years since the first foreign invested project came to Hai Phong, the sector went from nothing to 48% of industrial output (1997). Budget revenue from the FDI sector has increased to 10% of the city's annual budget (1997). Employment in the sector now accounts for about 7% of the industrial labor force, or some 8,000 workers.

Hai Phong's strategy for FDI is to attract foreign capital into a mix of heavy industries that are capital intensive and light processing industries. By focusing foreign capital on heavy industry, the city can free up its own resources to allow domestic enterprises (both private and locally-owned SOE's), which are capital constrained, to invest in light industries.

FDI in capital intensive industries, like cement (Chin Fong) and steel (Vinausteel, VPS, Vinapipe), were responsible for the rapid growth in the past two years.

Other heavy industry investments that the local authorities have identified for foreign participation are railway rolling stock, chemicals, plastics, ship-building and petrochemicals, automobile assembly, and motorcycle assembly.

Local authorities have identified a number of processing industries where they would like to encourage investment. These include plastic accessories, motorcycle assembly, pharmaceuticals, various agriculture processing etc. This list represents a reasonably small number of projects that may or may not be competitive. In any case, the sectors are open to competition on the domestic market or export oriented so they should not prove to be a drag on economic growth, should investors wish to pursue them.

Dramatic slowdowns in both the domestic cement and steel markets are making it difficult for foreign investors in both of these sectors to maintain profitability and

make it unlikely that past growth will continue into the future. Since June 1998 when the steel sector was up 10% for the year, it has had two consecutive months of reductions in output greater than 10%.

Prior to the economic slowdown, FDI approvals in Hai Phong were \$120 million in 1996 and \$397 million in 1997. During 1998, FDI approvals are down markedly. Only 3 investment licenses have been granted worth only \$7.7 million. Most projects approved in 1997 are facing financial difficulties and are either being cancelled or postponed. For example, a Korean paper factory has been cancelled. One of three foreign partners in the Dinh Vu IZ has pulled out for financial reasons. The second phase of the Chin Fong Plant is unlikely to go forward.

In a very real sense, foreign capital inflow to the heavy industry sector has come to a halt. All of this may, in the end, be to Hai Phong's benefit as funds are no longer committed to non-competitive capital intensive sectors, but are reserved for more productive, export oriented, light industry.

Infrastructure for Industry

In order to support the development of industry and trade in the priority areas, the city has outlined a series of infrastructure investments to be undertaken either with budget funds, ODA, or foreign investment. This is an encouraging list. With the exception of the power plant, most of the priority investments appear to be modest infrastructure upgrades that may have high economic returns, including water, sewage, road upgrades and urban infrastructure.¹² The new channel to the Hai Phong Port is expected to provide a new, silt-free approach to the current port and the planned Dinh Vu Port. Upon completion of the channel the port will be able to accommodate ships up to 30,000dwt. With the exception of the power plant, priority investments in Hai Phong total almost \$500 million.

Industrial Zones

Hai Phong has indicated a preference for the development of industrial zones. In the case of Hai Phong, five zones are expected to focus development of FDI and local businesses in a range of heavy and light industries. The highest profile of the industrial zones is the Nomura Industrial Zone in Hai Phong. This zone was opened in 1995 and has succeeded in attracting only 5 modest Japanese investments.

Nomura has not marketed its zone to private sector companies in Hai Phong. What marketing it has done to date has been limited to Japanese companies. Nomura officials expressed the hope to the study team that they might be able to attract Japanese auto parts suppliers to set up in their zone.¹³ Nomura has recently contracted the Singapore-based sponsor of the Vietnam Singapore Industrial Zone (Binh Duong Province) to assist it in its marketing efforts.

¹² Under all scenarios, licensing and management of a power plant falls under the jurisdiction of Electricity of Vietnam and the Ministry of Industry, not local governments.

¹³ This is in spite of near collapse of the auto assembly industry in Vietnam.

Hai Phong's private sector has at least four main objections to moving into the Nomura Zone. First, it is too expensive relative to the options. Private sector companies complain that it is much too expensive to set up in IZ's. Enterprises now looking to expand facilities (shoes and garments) are not infrastructure intensive. They require much less in terms of infrastructure and are not willing to pay for facilities that they will not require. Industrial zones that provide services, like common warehousing, payroll, etc. will find that private sector firms are still very much 'family affairs' with very little professional management. They are not likely to want to buy into many of the value-added services that industrial zones will provide and will view them as an 'unnecessary' expense.

Second, private sector businesses often lack access to the large amounts of credit required to rent land and finance construction of new facilities in industrial zones. More often, they will take adapt existing facilities or make simple additions to current facilities in order to reduce their total costs and limit their financing needs.

Third, private sector producers would like to maintain a lower profile with the local authorities than an IZ would provide. There they would come under the direct supervision of a host of authorities (tax, environment, labor, etc) which might otherwise deal with them more leniently, or on a 'preferred' basis.

Third, the number one factor in the location decision for private sector businesses, particularly those in shoes and garments is access to large pools of cheap labor, not infrastructure. Private sector light industry tends to locate near rural and semi-rural population areas in order to get access to cheap labor. The Nomura Zone is located ten minutes from central Hai Phong and hardly qualifies as a semi-rural location.

Hai Phong Industrial Zones

IZ	Size	Industrial sector
Minh Duc Iz	400 hec	Cement steel, shipbuilding, chemicals
Vat Cach-Quan Toan	453	Steel, ship repair, high-tech
Nomura	153	High tech
Dai Loan	300	High tech
Dinh Vu	1200	Heavy industry, consumer goods
Rte 14 EPZ	980	Export processing
Kien An-An Lao	300	Garments, shoes, food processing

Whereas the Nomura Zone has been a failure, Hai Phong has had successes in other zones. In particular, the An Trang Zone and the Rte 14 Zone have been attracting shoe factories in need of expansion space, including some of the larger private shoe companies. The Rte 14 Zone currently hosts two shoe factories belonging to Dinh Vang (private), and one factory each belonging to Thanh Hung and Thien Vinh (both private).

Unlike the Nomura Zone, the An Trang and Rte. 14 Zones are more similar to zoned areas than they are to industrial zones. The city provides relatively little in the way of infrastructure. The city simply provides easy access to land in these areas for light industry and export processing activities. The zoned areas are also located close to rural populations so the firms are assured of a steady workforce. The decentralized

nature of the zoned areas provides private businesses with confidence that they are not falling under the management of any additional governmental body or bureaucracy when they set up shop.

Recent experience in Dong Nai outside Ho Chi Minh City (the most successful province at attracting investment into industrial zones) shows that the more flexible the industrial zone is, the more successful it is likely to be. Some of the most important customers for industrial zones will be the capital constrained small and private businesses. Usually, they cannot afford rents at the highly developed zones, like Amata and Bien Hoa 2. Instead the local authorities in Dong Nai encourage them to consider cheaper locations in 'rural areas'. These semi-developed areas are zoned for industrial development, and do not have the same level of infrastructure and management a more formal zone.

This 'mat-rolling' approach is now being applied in more developed zones as well with equal success. Rather than build an IZ with completed infrastructure, management of the zone completes only some very basic facilities, including waste treatment, electricity and water/sewage. In these mat-rolled zones, as infrastructure is required the zone authorities and the individual investor can decide where and how much to be invested in order to suit their needs.

Ports

Hai Phong has an existing port facility that it would like to expand in order to meet growing demand for containers. Utilization of the existing Hai Phong port has grown from 2.5 million tons of throughput in 1990 to 4.8 million tons in 1998.¹⁴ The Hai Phong Port is the main gateway to the world for northern provinces, in particular provinces in the Red River Delta.

Though the Hai Phong Port is managed by the central government, local authorities understand the importance of their position and are determined to make incremental investments in order to guarantee that they will be able to continue to meet demand for port services into the future.

Unlike other 'downtown ports' land is not the main constraint on the growth of the port. There are large tracts of unused land along the Bach Dang River downstream from the city that the port can develop. Particularly as the port upgrades its handling facilities and cargo becomes containerized, additional space to upgrade capacity becomes less important.

The main constraint on the Hai Phong Port is siltation in the Nam Trieu area where the Bach Dang River spills into the Eastern Sea.¹⁵ Currently siltation limits the size of ships entering the Hai Phong Port to between 7,000 and 10,000dwt. The siltation problems require an ongoing program of dredging in order to maintain access to the current port.¹⁶ The annual cost of dredging the current channel in order to keep the port open to ships of up to 7,000dwt at any time and 10,000dwt with reduced load is

¹⁴ Current port capacity is 5.5 million tons/year.

¹⁵ i.e. South China Sea.

¹⁶ It is for that reason that planners at the Ministry of Transportation have long sought to develop a large deep-water port at Cai Lan in Ha Long.

\$2 million. Hai Phong authorities have plans to open a new channel to the port. This new channel would circumvent the areas of greatest siltation and provide better access to Hai Phong for ships up to 30,000dwt.¹⁷ Estimated cost for the new channel is \$70 million.

Current plans by local authorities also include expansion of the port to include the Dinh Vu IZ which has better access to Rte 5. Local authorities hope to bring in a floating port first (\$13 million) and as demand grows replace that with a more permanent facility. The Dinh Vu extension is planned to accommodate container traffic and support the adjacent Industrial Zone. In the first phase, the floating port will be able to accommodate ships up to 10,000dwt and have an annual capacity of 500,000 tons per year. As demand increases, incremental investments will be made by the Industrial Zone to eventually expand the port to accommodate ships up to 30,000dwt and with an annual capacity of 12 million tons per year.¹⁸

Total costs for the upgrade of the Hai Phong and the establishment of the Dinh Vu Port, including the dredging of a new canal is in the range of \$90 million. *(See related box on port development.)*

¹⁷ The new approach would take shipping traffic through Ha Long Bay, north of Cat Ba Island and then down to the port. There have been no studies to date on the environmental impact on Ha Long Bay of this new route, though the impacts might not be substantially different from the proposed Cai Lan Port.

¹⁸ The Ministry of Transportation has been generally opposed to the Dinh Vu Port project as it competes directly with the Cai Lan Port, which it sponsors.

Hai Phong Special Economic Zone

The government has recently agreed to review a proposal by the local authorities of Hai Phong to create a special economic zone in Hai Phong. While it is not yet clear what the final disposition of the proposal will be the direction of the local government is clear.

The most recent proposal begins with the recognition that current administrative structures are overbearing confused and not productive. In that regard, the current model borrows heavily from the Chinese experience. Current measures being considered as part of the zone include:

- 1) Approve investment licenses for domestic and foreign investor's;
 - a) export processing investments up to \$40 million
 - b) all of other enterprises up to \$10 million
- 2) Local authority to manage land.
- 3) Local authority to license businesses.
- 4) Trade taxes waived inside the zone.
- 5) Liberalize financial sector in Hai Phong.
- 6) Liberalize visa and immigration formalities.

The lessons of China's experience with Special Economic Zones have been clear. Decentralization of authorities and responsibilities along with reductions in trading barriers has led to spectacular growth. However, the proposal by People's Committee attempts to make the 'simplification' process as complicated as possible.

Rather than cover one geographic area, the Hai Phong proposal will attempt to administratively organize several geographically distinct areas within in the city's limits into an SEZ. Within the proposed Hai Phong SEZ there are smaller units, like a 'free trade port' and an 'export processing zone' and a 'preferential tax zone.' It is unclear what the importance of these different kinds of zones within the overall SEZ structure will be. Is there to be different tax treatment for companies inside each of the zones. Will some areas of the SEZ be more 'special' than others? Will preferential areas be fenced off from non-preferential areas?

In implementing its proposed SEZ, Hai Phong will have to be careful to ensure that they do not create too many new administrative mechanisms or make the operations of the Zone too confusing, lest they risk failing. For example, the SEZ management authority will have power to make laws, and approve investments, etc, but it will report to the People's Committee of Hai Phong, which will not have as broad authority.

There are numerous areas of uncertainty and confusion in Hai Phong's SEZ proposal to the central government and it is not clear that implementation in its current form will be feasible.¹

Roads

The completion of Rte 5 and the upgrade of Rte 10 will improve and enhance Hai Phong's position as a crossroads and will support the natural growth of industry along these corridors.

The upgrade of Rte 10 is particularly promising as it will allow light industry to get direct access to Red River Delta labor. The portion of the upgrade connecting Rte 10 to Quang Ninh by bridge has been delayed indefinitely.

This will likely mean more rapid development of Hai Phong industries in the general direction of the most abundant supply of cheap labor: south along Rte 10 towards the Red River Delta.

Conclusion

In light of the rapid growth of light industry and the slowdown in implementation of heavy industry plans, it might be appropriate for local authorities to reconsider their industrial priorities and concentrate on those activities that have the highest return and absorb the most amount of labor.

The 'organic' growth spreading out from Hai Phong along Rte 5 and down Rte 10 might lead local authorities to consider a new focus for the northern 'growth triangle' concept. An 'organic' industrial development zone might be one that tracks from Hanoi south along Rte 1, then north up the upgraded Rte 10 to Hai Phong, and finally along Rte 5 back to Hanoi.

This 'Red River Growth Triangle' promises to be more successful in the development of export-oriented light industries than any other alternative in the northern highlands. The Red River Delta, of which Hai Phong is a part, has vast amount of low-cost rural labour who are increasingly in need of off farm employment. Ready infrastructure connections between Delta provinces and existing port services can support growth in the industrial sector to the South and West of Hai Phong. Finally, businesses are increasingly choosing to locate along the Rte 5 and Rte 1, making industrial development in this direction more likely.

Hai Phong Major Industrial Products

Million dong, 1994 prices

	1996	1997
Stone breaking and mining	51,027	58,876
Central SOE's	6,223	6,689
Provincial SOE's	15,909	20,796
Non-state	28,895	31,391
FDI		
Food & beverage production	243,420	291,024
Central SOE's	117,757	142,080
Provincial SOE's	80,224	88,308
Non-state	45,439	60,636
FDI		
Tobacco	213,161	245,015
Central SOE's	0	0
Provincial SOE's	213,161	245,015
Non-state	0	0
FDI	0	0
Textiles	91,464	88,242
Central SOE's	12,095	6,140
Provincial SOE's	48,774	56,768
Non-state	13,170	9,974
FDI	17,425	15,360
Garments	70,544	77,640
Central SOE's	0	0
Provincial SOE's	48,774	56,768
Non-state	21,770	20,872
FDI		
Shoes & Slippers	910,463	1,314,317
Central SOE's	0	0
Provincial SOE's	426,801	564,931
Non-state	285,093	499,496
FDI	198,569	249,890
Wood Processing	16,440	12,920
Central SOE's	0	0
Provincial SOE's	1,102	1,304
Non-state	8,042	10,566
FDI	7,296	1,050
Paper Products	87,087	113,989
Central SOE's	8,361	11,712
Provincial SOE's	66,727	72,036
Non-state	11,999	30,241
FDI		
Printing	5,183	5,894
Central SOE's	0	0
Provincial SOE's	2,167	2,660
Non-state	3,016	3,234
FDI		
Chemicals	144,142	258,721
Central SOE's	17,913	21,337
Provincial SOE's	98,680	114,279
Non-state	27,549	34,585
FDI	0	88,520
Rubber Products	116,325	156,274
Central SOE's	104,362	138,543
Provincial SOE's	3,262	3,287
Non-state	8,701	13,294
FDI	0	1,150

Cement	499,131	1,185,888
Central SOE's	418,801	318,944
Provincial SOE's	28,126	33,764
Non-state	38,610	21,170
FDI	13,594	812,010
Metals	710,860	920,140
Central SOE's	54,297	52,621
Provincial SOE's	42,653	35,837
Non-state	20,253	18,552
FDI	593,657	813,130
Metal Products	186,771	214,540
Central SOE's	39,027	45,546
Provincial SOE's	3,676	0
Non-state	31,459	32,054
FDI	112,609	136,940
Agricultural Machinery	45,618	58,115
Central SOE's	0	0
Provincial SOE's	31,442	36,156
Non-state	1,488	1,889
FDI	12,688	20,070
Electrical equipment	63,883	87,454
Central SOE's	22,312	21,629
Provincial SOE's	23,002	2,902
Non-state	3,763	2,173
FDI	14,806	60,750
Radio-TV Assembly	31,571	6,855
Central SOE's	0	0
Provincial SOE's	31,471	6,830
Non-state	100	25
FDI	0	0
Vehicles	7,262	9,982
Central SOE's	0	0
Provincial SOE's	5,719	5,608
Non-state	1,543	4,374
FDI	0	0
Other transport	204,545	210,838
Central SOE's	168,655	184,022
Provincial SOE's	23,819	6,821
Non-state	12,071	19,995
FDI	0	0

Source: Dept of Statistics, Hai Phong

Survey of Export Shoe Companies in Hai Phong

Company		1994	1995	1996	1997	Volume in pairs
						Subtotal
Cty Tham len	SOE	136,560	656,340	491,630	487,580	1,772,110
Cty Da giay HP	SOE	3,483,999	4,483,132	4,616,992	3,703,501	16,287,624
Cty Kainan (JV)	FDI	2,352,694	1,534,949	1,901,301	1,160,618	6,949,562
Cty Giants (JV)	FDI	1,150,000	872,578	963,000	1,188,044	4,173,622
Cty Chau Giang TNHH	Priv		210,000	480,000	1,565,386	2,255,386
Cty Dan Sinh	SOE	1,090,123	393,349	101,737	55,540	1,640,749
Cty Dinh Vang TNHH	Priv		1,734,294	1,881,079	1,889,915	5,505,288
Xn Thanh Cong	SOE	259,259	819,790	913,118	1,039,780	3,031,947
Cty Thanh Hung TNHH	Priv	139,965	492,187	524,830	824,636	1,981,618
Nm Thong Nhat	SOE	426,600	587,800	156,717	762,861	1,933,978
Cty Thai Binh Duong TNHH	Priv				144,672	144,672
Cty Hop Luc		837,340	424,449	246,590	402,859	1,911,238
Cty Thien Vinh TNHH	Priv				46,860	46,860
Total		9,876,540	12,208,868	12,276,994	13,272,252	47,634,654
			24%	1%	8%	
Export Value InUS Dollars current Price						
		1994	1995	1996	1997	Subtotal
Cty Tham len	SOE-HP	976,927	5,327,493	4,128,994	1,267,033	11,700,447
Cty Da giay HP	SOE-HP	15,891,966	21,306,443	21,790,173	18,278,800	77,267,382
Cty Kainan (JV)	FDI	12,749,100	10,122,900	11,687,845	10,950,674	45,510,519
Cty Giant-V (JV)	FDI	4,878,963	4,247,070	5,000,000	6,164,930	20,290,963
Cty Chau Giang TNHH	Priv		1,260,000	2,880,000	9,881,738	14,021,738
Cty Dan Sinh	SOE-HP	1,692,271	1,002,298	305,839	194,495	3,194,903
Cty Dinh Vang TNHH	Priv					-
Xn Thanh Cong	SOE-HP	726,254	2,366,079	2,709,355	3,030,572	8,832,260
Cty Thanh Hung TNHH	Priv	279,930	984,374	1,049,660	1,650,038	3,964,002
Nm Thong Nhat		452,931	605,799	382,343	1,386,190	2,827,263
Cty Thai Binh Duong TNHH	Priv				672,307	672,307
Cty Hop Luc		3,368,047	1,464,617	899,606	1,463,682	7,195,952
Cty Thien Vinh TNHH	Priv				266,596	266,596
Total		41,016,389	48,687,073	50,833,815	55,207,055	195,744,332

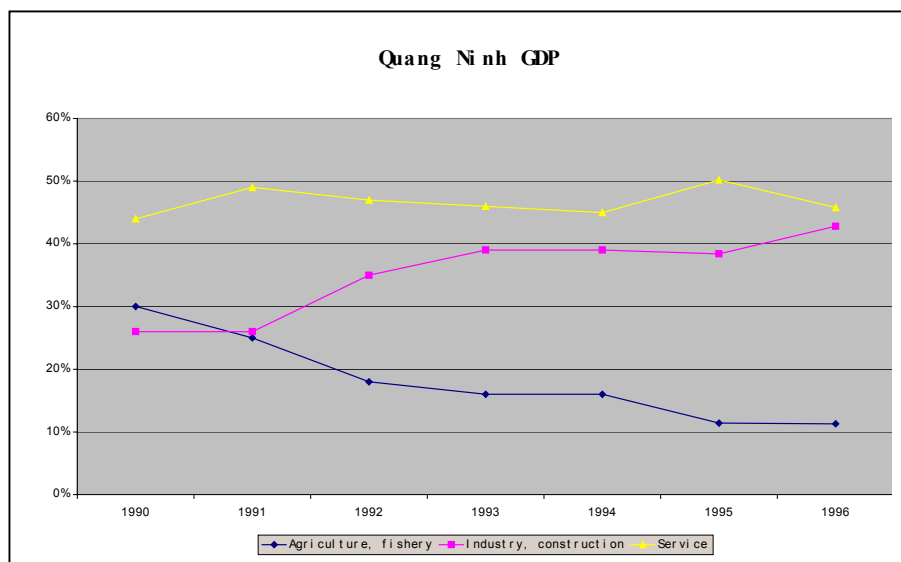
Hai Phong Foreign Direct Investment List

Project	Value (VND)	Description
1. Public Infrastructure		
Do Son Highway	25,000,000	29KM, 43m expansion and upgrade
Quy Cao Bridge	10,000,000	500m long, 12m wide
Da Bach Bridge	18,000,000	500m long, 12 m wide
Rte 14 Industrial Zone	200,000,000	300hec
2. Machinery and Equipment Manufacturing		
Construction Machinery Manuf	5,000,000	Concrete mixers, elevators, etc.
Diesel Engine Manuf.	20,000,000	
Construction Machinery Assembly	20,000,000	
Electric Motors	5,000,000	1-75KW motors
Tire tube plant	2,000,000	
Electronic game sets	8,000,000	
Electronic Accessories	7,000,000	
Freezers, Refrigerators	5,500,000	
Plastic Accessories	10,000,000	For cars, motorcycles
Agricultural Machinery	5,000,000	
Accessories for Ships	2,000,000	
Railway rolling stock	100,000,000	
High pressured cylinders	5,000,000	
Battery Manufacturing	2,000,000	
Container Manufacturing	22,000,000	9,600 TEU/yr.
Ship building & repairing	88,000,000	10,000-30,000dwt
Car Assembly	80,000,000	20,000 units/yr
Motorcycle Assembly	50,000,000	100,000 units/yr
3. Agriculture		
Clean Vegetable Plantation	3,000,000	50ha
Fruit juice processing	2,000,000	
Mineral Water	3,000,000	20 m l/year
Pig breeding for Export	3,500,000	
Milk cow breeding	3,000,000	
Poultry	1,000,000	
Production of seedlings	2,000,000	
Husbandry	3,000,000	
Seafood Raising	1,000,000	
Cannery	5,000,000	
4. Construction		
Construction Glass	10,000,000	
Bitumen	2,000,000	
Aluminum Frame	3,000,000	
Lighting/Decorative Lamps	3,000,000	
5. Metallurgy		
Sheet steel	1,500,000	
Steel Mill	100,000,000	1,000,000 t/yr
Steel Plate Mill	100,000,000	500,000 t/yr
Iron casting	5,000,000	
Copper casting	3,000,000	
6. Chemicals		
Solid Waste Treatment	15,000,000	
Candles for export	4,000,000	
7. Pharmaceuticals		
Chinese/Western Medicines	8,000,000	

8. Garment & Footwear		
Materials for shoemaking	5,000,000	
9. Petroleum		
Oil Refinery	400,000,000	50,000 bpd
Asphalt Processing Plant	80,000,000	
Lubricant Blending Plant	12,000,000	
10. Hotel & Tourism		
High Speed Boat Tours	3,000,000	Ha Long Bay Tours
Cat Ba Island Development	300,000,000	
Nui Vui Tourist Complex	50,000,000	
Do Son Resort	250,000,000	
Upgrade existing hotels	50,000,000	
Serviced Apartments	20,000,000	
11. Hospital & School		
International Hospital	5,000,000	
International School	5,000,000	

Quang Ninh

The obvious standout in Quang Ninh's economy is the absolute dominance of the central government, through the coal industry. The relative importance of the industry has not diminished with time. In fact, in the past few years, the coal industry started a program to restructure its management. As a result, it has increased its contribution rather than decreased its contribution to the provincial economy. Agriculture has always been held a relatively small share of economic activity and



this is rapidly declining as the poorer rural areas in the province are unable to keep up with urban areas and the coal sector. According to the Ministry of Agriculture and Rural Development, prospects for rapid agricultural based growth in Quang Ninh are limited.

Like so many 'one company towns' in the world it is not remarkable that in spite of economic reforms and increased openness there has been such little development of the private sector, not to speak of the local state sector. It should be noted that composition of industrial output was relatively static until 1995, relying almost entirely on the coal sector for its industrial base. Since the reorganization of VINACOAL, this reliance has increased dramatically. Local SOE's and the private sector, already small, began to shrink in absolute and relative terms once VINACOAL began to bring different activities 'in-house.' Local SOE's (workshops and repair shops) that served the coal sector found their business disappear as VINACOAL consolidated activities under its own umbrella. Private sector firms engaged in coal mining and processing were outlawed as part of the consolidation.¹⁹

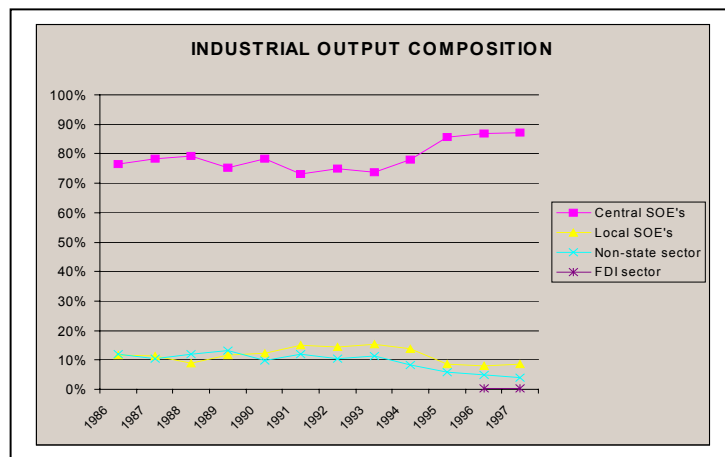
What industry there is outside the coal sector is limited in size and scope. In Quang Ninh, there is virtually no textile or garment industry. There is no shoe industry.²⁰ Food processing is split between fisheries and the provincial beer company.

¹⁹ Much of the private sector mining and processing still goes on, but it happens under the VINACOAL umbrella. Private sector operators must pay a fee to VINACOAL in order to conduct limited business.

²⁰ The Ministry of Planning recorded 73 people in Quang Ninh working in the shoe business in 1995. In 1996, the value of output of the shoe sector in Quang Ninh was zero.

The continuous decrease of the provincial SOE share in the industrial output shows not only the increasing importance of coal production but also the disappointing trend of the local industry. In 1997 local share was only 10% of industrial output while the comparative figure of the nation was 56%.

Local industry contributes only 10% to the province's industrial output. Local industry lacks competitiveness. For example, when VINACOAL started to have its own in-house repair service, the local repair industry collapsed. Fishermen, unhappy with high prices and poor quality, are asking for the right not to use shipbuilders from the province. All large construction projects recently awarded in the province have been won by contractors from outside Quang Ninh



Employment in the industrial sector in Quang Ninh, unlike in Hai Phong, is dominated by a single employer - VINACOAL. After the coal sector, construction materials – brick and tiles absorb labor and make contributions to output. The absolute dominance of VINACOAL has created a dependence on the company for employment that is obvious.

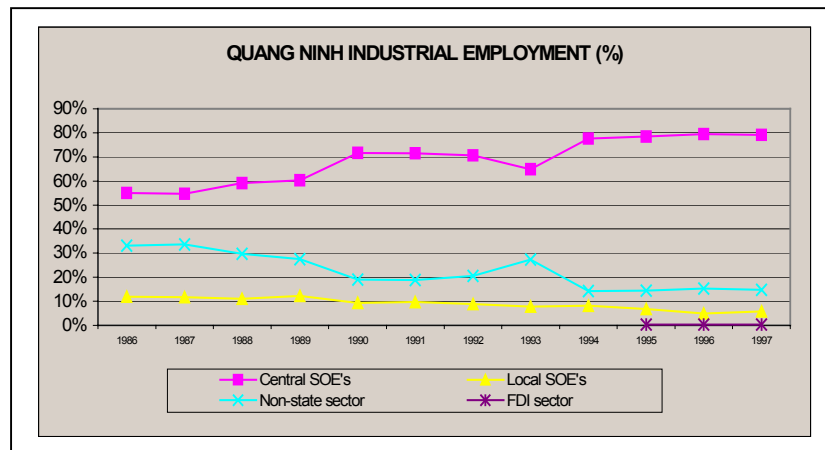
Unemployment and redundant mine workers will become the number one socio-economic problem over the medium term. Unemployment pressure has not yet been clearly recognized by local authorities as an important issue. However, this will be a problem now and into the future. It will become especially important if the Province goes ahead with its heavy industry program.

The unemployment rate in Quang Ninh is approximately 9.33%, with a high rate of underemployment. Fifty two percent of Quang Ninh's population is living on agriculture, forestry, and fishery. However, the share of GDP in these sectors is only 11.3%. Underemployment in the rural sector is high, with labor reporting work only 60% of the year. Unemployment and underemployment in Quang Ninh are higher than the national averages. Given a relatively slow growth of agriculture, more and more labor will have to seek for non-agricultural jobs and put additional pressure on Quang Ninh's industrial sector to supply work.

Local authorities claim that VINACOAL needs to be more active in solving social problems and creating non-mining employment activities. Local authorities claim that

VINACOAL needs to be more active in solving social problems and creating non-mining employment activities. The local authorities would like VINACOAL to set up a variety of workshops in garments and shoe manufacturing in order to create employment for unemployed workers and the wives of miners.

A local government report on the status of entrepreneurship in the province indicated that the single biggest obstacle to the development of private businesses is the continued reliance by individuals on VINACOAL for employment and services.



With respect to light industry, local government authorities express the attitude that light industry is mainly to create employment and not a money making venture. They have little understanding of markets and market needs and customers. In their view, light industry exists in order to provide jobs for the unemployed wives of miners. In that vein, the province and VINACOAL are to develop capacity for garment exports first and then customers will come to the province later. This kind of thinking reflects a strong central planning mentality and is not likely to lead to a vibrant garment industry.

The local government authorities in Quang Ninh expressed a dislike for the shoe industry (too competitive and volatile) and expressed a preference for the garment sector (to be specific, a preference for quota based exports to the EU) as it is more stable. Development of the garment and shoe sector in Quang Ninh has been slow. There are presently only 800 people working in the garment industry in Quang Ninh. The province has modest hopes to raise this to 2,000 by the year 2000. The Province organized a shoe plant to employ some 600 people, but it was closed due to the lack of competitiveness in the business.

The organized private sector in Quang Ninh is amazingly small. In 1998, there are 279 enterprises, most of them either in trading or construction (71%).²¹ Only 14% of private business are engaged in any sort of manufacturing. Total registered capital in the private sector is only 119.7 billion Dong (US\$8.5 million). Again the majority of that (82%) is confined to trading and construction activities.

²¹ Includes private companies, limited liability companies and joint stock companies. Excludes the household sector.

More telling is that 95% of all private companies in Quang Ninh Province have been registered in the Mong Cai Border Zone. Local authorities seem to be much more open to developing a successful private sector than authorities at the provincial level. The degree of that support is evidenced by the heavy weighting of registrations in Mong Cai versus anywhere else in the province.

One survey conducted in September this year by Quang Ninh's Planning and Investment Department revealed that of 279 registered entities, 23 had stopped operating, 17 failed to meet tax obligations, 68 had registered and been licensed, but never started operations. These figures, when added together, account for 38.7% of the total registered entities.

Industries	Number of enterprises	%	Capital (in VND billion)	%
Total	279	100	119.7	100
Trading	153	55	38.3	32
Construction	46	16	59.9	50
Manufacturing	31	14	14.4	12
Others	49	15	7.2	6

The share of the private sector in total GDP is small (less than 20%) and stable. Its share in industrial output is even more disappointing (less than 5%). The sector's share in industrial employment is larger (around 15%) relative to its output share suggesting that private industry is relatively labor-intensive compared to the state sector. Contribution to local budget is very small (around 10%).

Indicator	Sectors	1995	1996	1997
Share of GDP	Total	100%	100%	100%
	State	83%	83%	82%
	Private	17%	17%	18%
Share of Industrial Output	Total	100%	100%	100%
	State	94.3%	95.1%	96%
	Private	5.7%	4.9%	4.0%
Share of Industrial Employment	Total	100%	100%	100%
	State	86%	85%	85%
	Private	14%	15%	15%
Share of Budget Contribution	Total	100%	100%	100%
	State	89%	91%	87%
	Private	11%	9%	13%

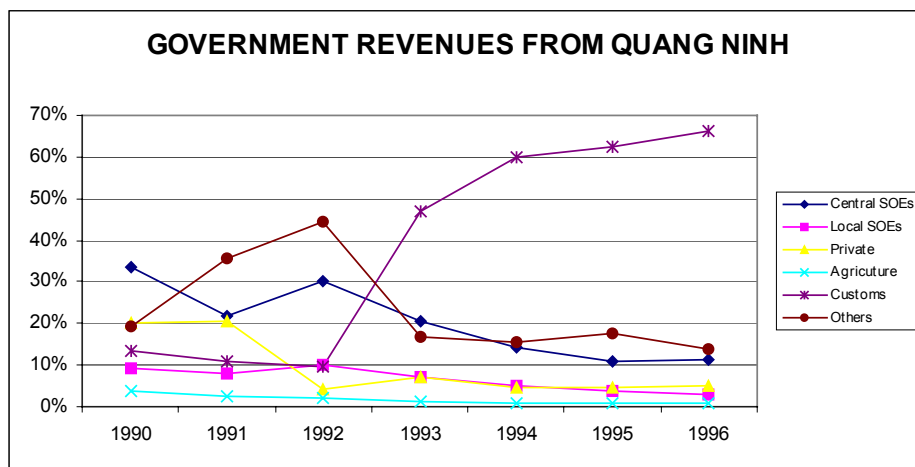
Local government officials do not expect that the private sector will be able to play an important role in generating economic growth and employment opportunities in the province. As a result it receives little attention of local officials and little support in a system where the rules are stacked against it.

Provincial policies and attitudes toward the private sector are not supportive of rapid development of the sector. For example, the provincial job creation strategy calls for investments in state industry but does not recognize that the private sector might play a role in job creation for the province. Also, the province's economic development strategy recognizes the 'seriousness' of state sector enterprises, while at the same time characterizing the private sector as a group of 'tax dodgers' and 'cheats' that need to be properly 'managed.'

A review of employment in the province tells a similar story. The coal sector currently provides direct employment for more than 71,000 workers, or 55% of all industrial employment. During the period 1994-1996, the coal sector was adding jobs at a rate of 12% per year. Employment growth has slowed to 4% since then. Current employment levels are some 25% above the average level of employment over the past decade. Outside analysts have noted the low efficiency of employment in Vietnam's coal sector.²² A recent review of the coal sector for the World Bank noted that only around 39,000 of total employment is directly or indirectly related to actual coal mining. The rest are employed in ancillary businesses that have little if anything to do with the coal industry.²³

The next largest sector in terms of industrial employment is 'processing' (i.e. brick and tile manufacturing). This sector is focused on meeting provincial and regional demand for bricks and tile. This sector, particularly tiles, is under increasing competitive pressure from Chinese and other tiles. Employment in this sector has been steady for some years. This sector does not show any employment growth potential.

The tourism sector, while it seems to have great potential, has actually provided very little direct employment. Employment has fluctuated between 1,800 and 2,000 for the three years. Tourism has potential to grow, but at current levels, it will require sustained rapid growth for a number of years before tourism actually provides employment for a large segment of the population.



Budget revenues have undergone a rapid change over the past seven years. These changes reflect the underlying changes in the economic situation of the province. Primarily, the rapid increase in the collection of trade taxes reflects the growing importance of trade and the Mong Cai Border Zone. Revenue from the private sector has been static, while revenues from the local state sector have been in steady decline. The decline reflects the negative impact of the VINACOAL consolidation in 1994/1995 on local SOE's.

²² At 155 tons/employee/year, VINACOAL falls far short of benchmark UK mines (2,600 tons/employee/yr).

²³ The Ha Long Heritage Hotel is owned by VINACOAL.

The biggest surprise from the Quang Ninh budget figures is just how little VINACOAL pays in taxes as a percentage of all revenue in the province. Local officials believe that VINACOAL should contribute more and that the company has unfair political advantages, which allow it to reduce its tax contributions.

Quang Ninh Development Strategy

The Economic Masterplan for Quang Ninh Province makes it quite clear that provincial leadership is resting its hopes for rapid and sustained growth on very weak legs. More alarming still is that the central government seems prepared to provide sovereign guarantees to uneconomic projects. This will only ensure that effects of slow growth are spread out across the entire country rather than being confined to a single province.

According to plan's estimates, during the period, 1996-2000, 75% of provincial GDP will come from the following sources (and in this order of importance):

1. Construction Materials
2. Coal
3. Tourism
4. Port Services
5. Export Processing and Heavy Industry Zones

Quang Ninh Investment Projects (Proposed)		
Name	Scale	USD
Transmission upgrades	81.5 km	26,000,000
HL-CP Water supply	120,000m ³ /day	33,800,000
Rte 18 (HN-HL)	180km	200,000,000
Rte 18A (CO-MC)	140km	200,000,000
Bai Chay Bridge	860 m	100,000,000
Cai Lan Port		150,000,000
Mui Chua Port	1,000t ships	2,300,000
HL-CP Water Drainage		25,000,000
Hoan Cau Cement	1.4 million ton/yr	250,000,000
Hoanh Bo Cement	1.4 million ton/yr	250,000,000
Hai Long Cement	1.4 million ton/yr	250,000,000
Lang Bang Cement	1.5 million ton/yr	280,000,000
Cua Ong Steel	1,000,000t/yr	560,000,000
VN-Japan Steel	500,000t/yr	120,000,000
DAP Fertilizer	330,000t/yr	275,000,000
Nui Beo Coal	1,200,000t/yr	30,000,000
TOTAL		2,752,100,000

If the goals of the province are rapid, sustained economic growth with employment generation, then the pillars of their development strategy are weak at best. In fact, it seems highly unlikely that these pillars will provide any growth at all in the current economic climate.

A cursory review of Quang Ninh's preferred investments gives a relatively clear indication of the priorities of the local authorities with regard to the development of industry in the province. The focus is squarely on large-scale infrastructure projects and heavy industry, particularly cement and steel. Compared to a similar list from

Hai Phong, Quang Ninh has a very non-diverse development strategy. It is precisely this concentration on heavy industry that will prove to be so risky.²⁴ Even if some of these projects are financed in the next several years, they will create burdensome debts and excess capacity rather than jobs and growth.

Heavy Industry Development

Cement

The highest priority development area, according to the People's Committee is the construction materials industry. First and foremost in that sector is the development of 10 million tons of cement capacity and additional development of tiles and other construction materials. Phase one is to consist of three plants planned to go on-line by 2005 with a total capacity of 4 million tons. Phase two of the plan will increase capacity to 10 million tons by 2010. The focus on cement is informed by the desire to take advantage of what is considered to be the province's comparative advantage.

Local provincial authorities argue that the study area is rich in limestone and coal and therefore makes the development of cement a natural industry for the area. Local officials also point to the abundance of coal in the study area that can be used to provide energy to the cement plants. With ready access to inputs and ready access to fuel, the local authorities try to make a strong case for the development of the cement industry.

It is quite true that the study area is rich in limestone, but one must remember that limestone is very common throughout all of northern Vietnam. There are at least seven other provinces, which can, and do, make similar resource-based justifications for the development of local cement industries.

With regard to access to coal, transportation costs associated with coal make up only 1-1.5% of total cost of cement and therefore do not play a critical role in the decision where to locate a plant.

From the outset it needs to be made clear that the economics and even the profitability of new cement plants in Vietnam is quite poor. That is neither the nation, nor the firm benefits from investing in expensive excess capacity. The Asian Crisis may be about to save provincial authorities from their own bad instincts. All three phase-one cement projects have now been either cancelled or postponed indefinitely by the primary investors.

That being said, local authorities are still wedded to the idea that the future of their province will be cement. A strong economic argument can be made that this is an unsustainable strategy that will provide neither long-term economic growth nor employment growth for the province.

With regard to the cement industry, there are three important points. First, from a financial point of view, cement has been an attractive option because the General

²⁴ While Hai Phong also has a list of large heavy industry projects, this list was balanced by a number of investments in light industries.

Cement Corporation has been able to exert market power and keep prices well above regional levels. However, the excessive financial returns to cement are drawing in more capacity. This is leading to very competitive domestic market where suppliers can no longer be assured of excessive margins.

Second, from an economic point of view, the cement industry as it is currently organized is not competitive at regional prices (though there might seem to be a lot of domestic competition). The government, through the General Cement Corporation, attempts to tightly control supply for the domestic market. As a result, domestic prices are above regional prices allowing inefficient producers to remain in business even when facing heavy domestic competition.

This situation is not sustainable over the long term as it allows a protected sector to continue to exist at the expense of consumers and producers who use cement as an intermediate input. By building a high cost economy in order to protect an inefficient sector, Vietnam becomes less competitive in other areas.

Local cement prices are now in the range of \$65-75/ton.²⁵ Ex-factory prices of cement in the more modern cement plants (Chin Fong) are in range of \$55-65/ton (Financing costs alone are in the range or \$23-25/ton). Smaller, standing furnace plants (Chinese technology accounting for 30% of all production) are producing in the range of \$35-45/ton of lower quality cement.

While financial margins are potentially very high, when one compares domestic prices to border prices for cement, it is clear that economic returns to cement are dismal.

Thai cement can be brought in cheaper. Import prices, duty paid, for Thai cement is now just \$28/ton, due mostly to currency fluctuations. In the Mekong Delta, Thai and Indonesian cement is reported selling at \$30/ton.²⁶ Imports from China across the Mong Cai border crossing are typically \$40/ton. Including forty-percent import duty and transportation costs, Chinese cement can be sold in Ho Chi Minh City, the country's largest market for \$68. In Quang Ninh and Hai Phong Chinese cement can sell for as little as \$60/ton, taxes and transport paid, much less if smuggled.

The main reason for such high production costs for cement is inflated input prices. Limestone is the primary input for cement. Limestone, though abundant all over Vietnam, is quoted locally at \$25/ton. US price for limestone is much lower, only \$15/ton.

Clinker, which is made from primarily limestone, sand and clay, is sold for domestically for \$40/ton, while it can be imported for only \$23/ton. The Ministry of Trade has decided to ban the import of clinker for the rest of this year and for 1999. This action is intended to support local clinker production and unnecessarily raises the ex-factory prices of domestic cement.

²⁵ Prices are down from all time highs of \$200/ton in 1995.

²⁶ This cement is smuggled. Cement is typically considered a non-tradable commodity, but the relatively large difference between local costs and regional costs make it profitable, even though the weight to value ratio is so low.

There is no reason for limestone, and hence, clinker prices to be so far out of line with international prices. Unless, these input prices are brought into line with regional and international prices, Vietnamese cement will always find it difficult to compete domestically, much less export.

Demand growth has recently slowed dramatically as a result of the general economic slowdown in Vietnam. Demand in the North has fallen by 4% this year. In the South demand has fallen by 2%. At the same time, capacity continues to come on-line. In 1997, domestic production was 9.3 million tons, while this year it is estimated at 12.4 million tons. At the same many of Vietnam's domestic cement producers are reporting utilization rates in the range of only 50%.

As a direct result of the very high margins in the cement industry, there has been a rapid increase in supply as provinces jump on the cement bandwagon. The market is now saturated. Competition amongst domestic producers of cement has eaten into their margins. By the IFC's estimates the market currently has over two million tons of excess capacity²⁷.

The General Cement Corporation is in the process of trying to exert some additional market control right now. It has proposed that marketing of cement be handled by a monopoly marketing company under its management rather than through current more decentralized distribution channels. By taking over marketing the General Cement Corporation hopes to reduce the amount of 'unfair competition' in the cement market that has resulted in (what they consider are) low prices for cement. That is to say, the Cement Company would like to raise margins further still. This will be difficult for them to do.

Quang Ninh authorities plan to export at least 2 million tons per year through the proposed Cai Lan port facility. However, with local markets priced at nearly double regional suppliers, it will be impossible for Vietnamese cement to find export markets, much less feel assured that they will be able to sell their product on the domestic market. This is particularly true now that the region has such a high degree of over-supply.

Exports, if there are to be any, will require subsidies. This is not a realistic scenario. It is much too costly for poor Vietnamese consumers to subsidize foreign countries just so that Vietnamese cement producers can export. At current prices, it will cost in excess of \$60 million per year in order to subsidize the planned 2 million tons of exported Quang Ninh cement so that it can compete against comparable Chinese cement on export markets.

Third, local authorities have vastly overestimated the employment potential associated with the development of a cement industry in the study area. From an employment perspective, adding large capacities of cement production will not result in high levels of employment. The current plan envisions 10,000 people working in the cement industry by 2010. Modern cement plants will not provide that much employment.

²⁷ However, the IFC apparently does not consider 20% oversupply much of a problem. It recently announced that it will provide financing to Vietnam's largest cement plant, the 2.4 million ton/year Nghi Son Plant. The IFC termed its participation in the project "a great achievement" and "a real coup." Given the economics of cement, it is unclear why they are so enthusiastic.

For example, the 2.4 million-ton Chin Fong plant in Hai Phong employs less than 400 people. Ten million tons of cement capacity (the maximum possible capacity for the study area) might employ as many as 3,500 people.

The current crisis in Asia will stop further investment by foreign and private participants in the planned cement plants. If local authorities are determined to pursue these projects on their own,²⁸ then they are in danger of investing large amounts of scarce capital into businesses that are not economically viable and do not absorb very much labor.

According to the government Masterplan for Industrial Development, the 1.5 million-ton capacity Lang Bang cement plant is to be developed by a Korean company with a sovereign guarantee.²⁹ At this juncture, giving sovereign guarantees to investors in cement plants is not a wise decision.

Given the current foreign exchange shortages and Vietnam's current exchange rate policies, it is more likely than not that investors will have to resort to these guarantees, thereby raising the overall level of pressure on the exchange rate and reserves.³⁰ It would be wise macroeconomic policy to eschew as many of these inefficient, import-substituting projects as possible in current conditions. They require too much foreign exchange to protect and offer little in the way of added economic benefit.

On the other hand, if local authorities take advantage of the current slow-down and re-evaluate their positions with regard to this and other sectors they may be able to direct their efforts (and their scarce foreign exchange) more productively elsewhere.

²⁸ This would not be unheard of. The Hoang Mai Cement Plant in Nghe An Province is a case in point. The \$230 million plant is being financed by French commercial loans to the People's Committee.

²⁹ Office of the Government: Sector Masterplan 1996-2000, 2920/QHQT, 18/06/96. The Masterplan indicates that foreign investors in 6 of 9 priority cement projects are to receive sovereign guarantees for commercial loans associated with those projects. The Chin Fong Plant, not on the priority list has also received one. The People's Committee of Nghe An also reports having received a sovereign guarantee, though this it is not indicated in the Masterplan. Including Chin Fong and Hoang Mai, there are more than 14 million tons of cement capacity slated to receive government guarantees with a potential liability to the Government of Vietnam of \$1.9 billion.

³⁰ Already, SaigonPetro, one of two state-owned oil importers (a priority sector), is reporting difficulty in gaining access to foreign exchange to import refined fuels.

Stagnant Steel Market

According to Vietnam National Steel Corporation, production in the first nine months of 1998 rose by 10% to 748,000 tons. At the same time, VNSC is reporting record high stocks of steel: [250,000 tons] just as demand for its product is collapsing. [Since August, production has been in quick decline, falling by 12% per month.]

This situation is due to their worries over the unstable exchange rate between the dong and the dollar and the cheap price of imported steel. Also, the government and provinces have suspended or cut many construction projects. An official from Vietnam Steel Corporation (VSC) said that most steel producers are operating at 50% of their design capacity. Many factories have difficulty paying worker's salaries.

At present, Thai Nguyen Steel Plant suffered from stockpile amounting to VND368.8 billion by the end of June and a heavy debt of VND258 billion. [Thai Nguyen has had to lay-off 25% of its workforce as a result of the slowdown.] Other steel producers are in the same position. Industrial experts predict that steel consumption in the coming months will not improve. Thai Thi Cam, head of Financial Distribution Department of the General Department of Planning and Investment said that the government was applying strict measures to limit infrastructure projects using state capital. This is a worrying signal for the steel industry. At the moment, even private construction projects are declining.

Steel production is subject to tax of 2% this year, but starting from next year, with the application of VAT, the rate will be 10%. The more steel is stockpiled, the more steel producers suffer from losses. A source from the VSC said that next year, losses in the industry would probably amount to tens of billion dong.

The steel industry is facing a difficult future and is seeking support from the government. (Vietnam Industry Sep 24)

Steel

Also in the construction materials sector, the province would like to focus on steel production. Quang Ninh would like to develop the capacity to produce 1.5 million tons per year at a cost of \$710 million.³¹ Total domestic supply of steel in Vietnam in 1997 was just over 950,000 tons, while demand was approximately 2.25 million tons in 1997.

While the goal here is to replace imports and not export steel, Hai Phong's recent experience should act as a guide for Quang Ninh with regard to the steel industry. Hai Phong's steel industries have had difficulty in achieving any level of profitability. Foreign invested enterprises in the steel sector have run into particular difficulties.

As indicated in the previous section, (see Hai Phong, Steel), utilization of existing steel capacity in Vietnam is already low and market prospects for steel manufactures are not optimistic. Stockpiles are now equal to 34% of last year's entire production and output is falling rapidly.

³¹ There are three steel-making projects on the national priority list (1996-2000) with a total capacity of 3.5 million tons/year. None of these projects has been granted a guarantee from the central government.

Though demand is expected to grow at an annual rate of 10% according to the Ministry of Industry³², the supply will likely grow more quickly as imports from Russia so not show much sign of slowing. Given the current, and likely future, fluctuations in the world market for steel it seems that Russian producers will continue to dump steel on markets like Vietnam.

As a result, over the medium term, incremental steel investments, regardless of the possible locational advantages associated with Quang Ninh and Hai Phong may not be wise investment from either a financial or economic perspective. This is especially true with regard to large investments that would double present installed capacity. As a result, these investments should be carefully reviewed before taking any further steps towards implementation.

Coal

While the coal sector is large (and will remain large) in absolute terms, it has limited potential for rapid growth. In fact, in employment terms, VINACOAL will have to reduce employment in order to become more efficient and profitable in the future.

Over the period, from 1980 to 1995, domestic demand for coal has risen at an annual rate of 4.6%. Average long-term growth in industrial demand for coal, including the power sector, is expected to be in the range of 5.6% per year.³³

Current demand for coal by the power sector is approximately 1.5 million tons per year. The commissioning of the 600MW Pha Lai 2 power station in 2001/2002 will double present power sector demand for coal.

Other non-electricity uses for coal have shown either consistent demand or moderate increases. Use of coal in transportation (i.e. railway) has decreased as the sector shifts more and more to diesel.

Export markets have grown quickly in recent years, but the world market for Vietnam's anthracite is relatively small (10 million tons) and this market is not expected to grow rapidly in the future. VINACOAL already has 40% of the world market for anthracite and will find itself increasingly under pressure from Chinese producers competing for market share.

On the sales side, the government sets a maximum price on the sale of coal to the national power utility (EVN) and to minority people in the mountains. The government does not set price restrictions on any other sales.³⁴ The maximum price for the electricity sector is between 270,000 dong and 300,000 dong per ton, delivered. Average production costs per ton are in the range of 286,000 dong and 325,000 dong per ton.³⁵

³² This estimate assumes 9% annual GDP growth.

³³ VINACOAL expects to achieve more rapid growth based on large amounts of bituminous coal reserves in the Red River Delta. Bituminous coal is ideal for power generation and enjoys a large world market. These reserves, however, lie entirely outside of the study area.

³⁴ The Chin Fong plant pays 330,000 dong per ton, delivered for coal for its plant in Hai Phong.

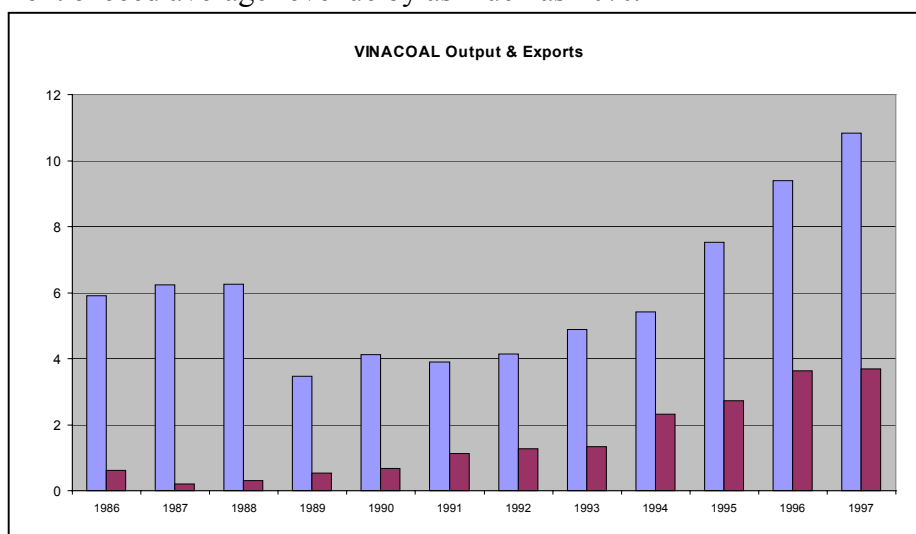
³⁵ A World Bank team estimated that VINACOAL needs to be selling coal at \$30-35 per ton in order to make a reasonable profit and be able to re-invest in the firm's development.

The electricity sector is VINACOAL's largest domestic customer and the customer with the fastest potential growth trajectory. However, sales to the power sector would only lead to greater losses if the current pricing system is maintained. The study team estimates that VINACOAL losses associated with sales only to the power sector are in the range of \$7.5 and \$12 million every year. VINACOAL's annual investment requirement in order to replaced depreciated equipment and machinery is equal to \$22 million, but VINACOAL is able to generate only \$15 million internally. More appropriate pricing of coal to the power sector could help VINACOAL cover investment requirements using internal funds, without commercial lending and central government credits. From an economic and business perspective, sales to the power sector, given current policy constraints, do not represent a viable future for the company.

VINACOAL has been arguing strenuously for raising its maximum sales price to EVN, but has not been successful. VINACOAL argues that it is required to operate at a profit but cannot do so if its only source of growing revenue causes the company to run at a loss. EVN, for its part, would be willing to pay higher prices for coal, but notes that it has the same problems as VINACOAL. It, too, is required to operate at a profit and it, too, is unable to get the government to agree to raise its retail sales price.

The recent failure of the 300MW Oxbow IPP, to be sited at Hoanh Bo in Quang Ninh, revolved solely around the question of whether or not Oxbow should receive EVN's subsidized price for coal. Oxbow argued that it should receive a subsidized price while VINACOAL argued that it should pay prices more in line with prices paid by cement producers.

Given the problems VINACOAL faces with pricing, it is not surprising that the firm is lukewarm with respect to the development of coal-fired electric power. On the one hand, demand from the electricity sector represents the fastest growing consumer segment for VINACOAL. On the other hand, average costs associated with serving this segment exceed average revenue by as much as 20%.



A primary objective of the 1994/1995 reorganization and centralization of the coal sector was the creation of a viable and profitable company that might compete more effectively on world markets. VINACOAL is obviously constrained on the sales side,

because export markets are limited and its largest customer is subsidized by state decree. VINACOAL will have to look elsewhere in order to create the internal cash-flow required to support its ongoing operations. The central government has refused to subsidize for continuing operations.

Improving productivity will be required in order to raise profitability and competitiveness. In that regard, VINACOAL is facing a relatively straightforward business-restructuring exercise. As VINACOAL improves its operations and increases efficiency it will have to reduce its workforce and upgrade its processes in order to lower its unit costs and remain competitive.

VINACOAL presently employs some 71,000 workers. Of this number, only 39,000 (55%) are involved either directly or indirectly in mining operations. Some 32,000 other workers are spread out across a host of ancillary businesses. These non-mining activities (including training centers, health facilities, schools, hotels, and construction companies) add to company overhead, but bring little revenue. Many of these business operations can be shed with little negative impact on the business side of VINACOAL's operations.

In fact, VINACOAL has an aggressive plan to upgrade 50% of its mining equipment over the next 2-3 years. The technology improvements may make redundant as many as 15,000 of its workers.³⁶

This technology upgrade, a necessity for VINACOAL's business will likely lead to tensions between the local authorities and the company on the issue of employment. In an attempt to appease local authorities, VINACOAL plans to lay-off non-residents first (12,000) and then only later Quang Ninh residents. One assumes that local authorities will attempt to deal with non-residents administratively. For residents of Quang Ninh, local authorities have suggested that VINACOAL organize garment and shoe factories to employ those made redundant.³⁷

Tourism

Quang Ninh is well-known for the Ha Long Bay World Heritage Site. The province has set a target of attracting one million tourists by the year 2000. Though Quang Ninh also has other tourist sites in Tra Co beach and the Yen Tu Pagoda, nearly all tourist investments, activities, and revenues are currently from Ha Long City.

According to provincial statistics, the number of tourists grew at an average annual rate of 39% from 1990 to 1996 or a six-fold increase in six years. An average annual

³⁶ This is an extremely sensitive issue politically and has not yet been approved. It may well be that upgrades are made and VINACOAL is not permitted to lay-off workers.

³⁷ VINACOAL employees who will be made redundant are predominantly male. The garment and shoe industries world-wide tend to employ mostly female workers.

rate of 52% growth in revenue was reported during the same period.³⁸ The fast growth in revenue might reflect the obvious improvement in hotel accommodation.³⁹

Through the years there have been few improvements in tourism services beyond increasing the number of hotel rooms. A few attempts to diversify tourist activities such as air-tours or speed-cruises have failed. In fact recent infrastructure improvements that were hoped to provide better access for tourists to Ha Long seem to have had an unforeseen negative impact. Average length of stay in 1990-91 was 1.9 days. It is now just 1.5 days.⁴⁰

Surprising as it may be, tourism still represents a very small fraction of the province's total economic activity. In 1994 tourism contributed only 1% to total GDP of the province. The sector reports revenue per tourist at less than US\$20 per visitor (with very little growth over the past five years).

With 370,000 tourists (excluding Chinese tourists to Mong Cai) in 1996 and growth of 10% from 1995, tourism in Quang Ninh needs to grow at 30% a year from 1997 to 2000 to reach the target of one million. Quang Ninh has only begun to get access to the Chinese tourist market. Since the border opening in 1989, this market has been growing quickly with 300,000 Chinese expected to cross the Mong Cai border this year. However, only 40,000 of these tourists will actually leave Mong Cai to come to Ha Long, where they tend to spend \$50 per day (more than double average revenue). The rest return to China after spending the day in Mong Cai and Tra Co beach. The challenge for Quang Ninh's tourism sector will be to encourage larger and larger percentages of Chinese tourists already in Quang Ninh to actually make the four-hour journey to Ha Long and spend the night.⁴¹

Also, more investment in tourist related activities may not lead to increased tourism and increased revenue, since the main attraction of Quang Ninh is and always will always be the World Heritage Site. Rather, an improved marketing effort (in collaboration with foreign tour operators in China and Europe) designed to bring in larger numbers of tourists might prove more effective in raising overall demand for tourism services of all quality levels.

At a macro-level, the regional crisis has had a negative impact on Vietnam's entire tourism market with overall arrivals down this year to 800,000. At a more micro level, Ha Long faces the prospective threat of an aggressive tourism sector in Hai Phong taking domestic and foreign tourists away from Ha Long and keeping them in Hai Phong and Do Son. With a similar access to Ha Long Bay and improved transportation to Cat Ba Island, Hai Phong might be able to claim a large share of tourists who might otherwise have gone to Ha Long.

³⁸ Data in nominal prices only.

³⁹ However, the data may not represent accurately the real picture because the inconsistency of the reporting system. For instance, in 1991 revenue increased 97% while number of tourists increased only 6%. Or in 1995 revenue decreased 12% while number of tourists increased 14%.

⁴⁰ Indicates demand for hotel rooms in the range of 1500-2000 rooms per night. There are now approximately 2,200 hotel rooms (with 4,700 beds) of all types, plus a number of guesthouses owned by large central corporations.

⁴¹ Of course, there is no guarantee that Ha Long Bay will prove to be an attractive destination for a large number of Chinese tourists as the limestone carsts that fill Ha Long Bay are also quite common across the border in Guangxi.

Infrastructure for Industry

The fourth and fifth priorities on the Province's list are primarily focused on infrastructure for industry. Local authorities have indicated that upgrading and developing infrastructure is an important development goal for the province. The local authorities hope that large-scale infrastructure investments will improve access to this remote province and thereby create economic opportunity. The bulk of infrastructure investments are concentrated on the new highway 18, the Cai Lan Port, the Bai Chay-Hon Gai suspension bridge and a number of industrial zones. This strategy threatens to create large monuments that have little, if any, economic value, and will probably only result in more debts that will be increasingly difficult to finance.

Unfortunately, it seems that the local authorities have confused issues. Rather than look for economic activity that requires additional infrastructure support, they seem to have focused on the development of infrastructure as a goal in and of itself without regard to demand for such services with the hope that infrastructure will attract economic activity.

Industrial Zones

Quang Ninh hopes to develop a number of industrial zones. Five industrial zones are to focus on the development of heavy industry, one will be for 'high-tech' and one (in Mong Cai) will focus on the development of light industry for export. Quang Ninh has had less success in its IZ strategy than Hai Phong, attracting only two investments (Vinaflour and Neptune) to its Cai Lan Industrial Zone. Both of these investments (food processing) serve domestic market. There are no exports currently associated with the Cai Lan Industrial Zone.

The majority of Quang Ninh's Industrial Zones are intended to support heavy industry. These zones are still undeveloped and there seems to be little demand for them. Without heavy government support in the way of financing, it is difficult to imagine that Quang Ninh will be able to attract very much investment to these industrial zones.

Planners of Quang Ninh's industrial zones have forgotten an important lesson of Dong Nai's experience in developing zones. For zones to be successful (i.e. have a high rate of occupancy) they must be located within close proximity of relatively large population areas so that factories can have ready and easy access to labor. In the case of the Hoanh Bo, Dong Dang and Cai Lan Industrial Zones, there are no population areas nearby (i.e. thirty minute bicycle ride).

In the longer term, the Uong Bi Industrial Zone may be able to attract investments in light industry. Thanks to recent infrastructure upgrades, Dong Trieu now enjoys easy access to Rte 5 and the Red River Delta. It is now possible for the western part of Quang Ninh to begin to increase interchange and economic activity with the Red

River Delta. More important, the Uong Bi/Dong Trieu area may be able to attract some light industry and employment opportunities from the Rte 5 corridor.

Quang Ninh has planned a 'high-tech zone'. What exactly 'high-tech' means, has not yet been defined by the local authorities. There are few locational advantages to high-tech businesses wishing to locate in Quang Ninh. By its own admission, Quang Ninh has very poor labor resources and a very low level of technical training and ability (outside of the coal sector). Computer usage, and networking are less apparent in Quang Ninh than in Hai Phong. There are no universities and there is no indigenous intellectual capacity that might support the successful development of a 'high-tech' zone. There is very little prospect for the foreseeable future that anything resembling 'high-tech' will inhabit the proposed zone.

Quang Ninh Industrial Zones, 1998

IZ	Size	Industrial sector
Cai Lan	90 hec	Engineering shipbuilding construction materials
Dong Dang	100	Heavy industry
Hoanh Bo	170	Construction materials Electricity
Uong Bi	850	Heavy industry
Mao Khe	400	Heavy industry
Mong Cai	80	Export Processing

In any case, the Ministry of Construction's Masterplan for Ha Long City envisions the 'high-tech' zone employing some 35,000 workers by the year 2010. Given the small size of the zone (90 hec), 35,000 is an improbably high employment figure. For example, the 'high-tech' robot Japanese factory located in the Nomura Industrial Zone employs just 100 people in a 33,000 sq m site. If the 'high-tech' zone in Quang Ninh is able to rent all of its land to similar enterprises, this implies a maximum employment figure for the entire zone of less than one-tenth of its projected level.

On the other hand, local authorities in Mong Cai are very active in promoting their vision of a light industry zone for the Border Area. If they are given permission to create a 'Free Trade Area' (*see section on Mong Cai*), then they will begin to market their town as a light industry processing area for Chinese businesses, which might well prove successful.

Ports

Years ago when ships were fired with coal, Quang Ninh was an important destination in Asia. With the decline of coal/steam-fired shipping, Quang Ninh lost its importance as a shipping destination. Nevertheless, provincial authorities, central government ministries and foreign lenders are determined to place a new port in Ha Long.

The Cai Lan Port was proposed for two reasons. First, the port is a natural deep-water port that can easily accommodate ships up to 20,000dwt and is capable of taking ships up to 40,000dwt in the future. Second, the central government's Northern Growth Triangle strategy has Ha Long as a center of heavy industry which will require a port.

The present Cai Lan (Quang Ninh) facility is relatively small with a current capacity of 500,000 tons per year. Total throughput this year will be approximately 400,000 tons most of that in support of the Malaysian invested Vinaflour and the Singapore-invested edible-oils bottling plant which are located adjacent to the facility.

Prior to these two plants coming on line, total volume through the Cai Lan port was only 40,000 tons/year, mostly general cargo. According to feasibility studies, port demand is to rise to 2.7 million tons by the year 2000, which is equal to the designed capacity of Phase 1 of the Cai Lan Port.

The plan is to combine the investment in the first phase of the port (\$150 million) with investments in Highway 18 (\$300 million) and a railway (\$300 million) to Hanoi. These combined investments (\$750 million) will support container traffic and general cargo from industries in Hanoi and other locations throughout the North.

Despite such a large planned investment, the associated investments are not clear. Port planners have made a number of significant errors in estimating demand (and therefore benefits) for port services in Cai Lan.

Planners began by estimating total growth for all northern port services between now and the year 2010. They then assumed that demand for Cai Lan Port will be this total less the total capacity of the Hai Phong Port, estimated to be 8.4 million tons per year.

There are a number of serious errors in this approach. First, it appears that there will be further development of the Hai Phong Port beyond 8.4 million tons per year. Local authorities have plans to add up to 12 million additional tons of capacity should the need arise at Dinh Vu in addition to the current port. This would bring total capacity of the Hai Phong to more than 20 million tons per year. (*see Appendix on Hai Phong and Cai Lan Ports*).

Second, the assumption that all demand for port services in excess of Hai Phong's capacity will shift to Cai Lan is difficult to reconcile with reality. For example, the busiest port in Quang Ninh presently is the Van Gia Port at Mong Cai which serves Chinese-Vietnamese border trade. Under the assumptions used to justify the Cai Lan Port, all trade now using the Van Gia Port would be shifted to Cai Lan. It is extremely unlikely that traders in rice, rubber and coal who presently use the Van Gia port to access China will be convinced to move to Ha Long. It is also extremely unlikely that local officials in Mong Cai or at the Provincial level would encourage the shutting down of the Van Gia Port because of its importance in the border trade with China.

Third, planned demand for the port in the Ha Long area was to come from a series of cement, steel power plants that have all now been either cancelled or indefinitely postponed. Phase one of the construction materials complex was to have 4 million tons of cement capacity, almost three million tons of which was to move through the port. This will not happen now nor for several year, or even longer. The steel plants, while now doubtful, were never planned to use the Cai Lan facility in the first place. The Quang Masterplan makes it clear that proposed steel plants are to be located in Cua Ong so as to have easy access to the Cua Ong port facility.

Fourth, the planners assume that Rte 18 will have heavy traffic loads. The proposed Rte 18 tracks through sparsely populated mountain areas to Hanoi. Currently, there is no industrial base in the area surrounding the new route and the industrial base north of Hanoi that would most likely use the new route is quite small.

Rte 18 is planned to support a series of Industrial Zones that are to make use of the port. If the port is to support import/export activity, then that means these industrial zones will be focused mostly on light industry. The most important factor in locating shoe and garment plants, according to managers, is proximity to large pools of labor.

If planners have their way, there will be a massive migration of workers from the Delta areas to the highlands to work in proposed manufacturing facilities that will apparently be built amongst a number of proposed Industrial Zones.⁴² On the face of it, this seems a very unlikely scenario.

More likely is that whatever industry that will use the port will be located in the Red River Delta and would not have easy access to the new Rte 18. Rather, industry in the Red River Delta would drive container cargo up Rte 10 to Hai Phong and then down Rte 5 to Dong Trieu and then finally across to Cai Lan, thereby bypassing the new Rte 18 altogether.⁴³ The vast majority of demand for transport services is in the Red River Delta (total volume of cargo 22 million tons/year vs. 8 million tons/year in the Northeast Region⁴⁴).

Those arguments aside, even if there were demand for the port and road as planned, and if the port and road were used to full design capacity (Phase 1: 2.7 million tons) debt levels associated with this project will be high. Each ton of cargo that used the road to get access to the port would have to pay a toll of \$5.20, or \$0.03/ton/km in order for the port and road simply to make annual debt payments on the incremental infrastructure.⁴⁵ The debt burden on the group of infrastructure projects supporting the Cai Lan Port alone makes it unlikely that the port will be able to competitively attract large amounts of cargo unless debt repayments are nationalized and the project is not held accountable for them.

If the goal is to provide better port services to exporting firms in northern Vietnam, those goals might be better served by more moderate investments in the Hai Phong Port rather than the development of infrastructure for which there is little actual demand.

⁴² The cost of the infrastructure for the proposed Industrial Zones is not included in the estimated cost of Rte. 18. The costs for 7 IZ's of the type presently discussed is in the range of about \$1 billion, when one includes infrastructure (including water and power) that will be required for each of the zones.

⁴³ Containers are not allowed on either the Binh or Rung Ferries on Rte 10, but are allowed on the Kien Ferry adjacent to the Nomura IZ in Hai Phong.

⁴⁴ The Northeast Region includes Ha Giang, Cao Bang, Lao Cai, Bac Can, Lang Son, Tuyen Quang, Yen Bai, Thai Nguyen, Phu Tho, Vinh Phuc, Bac Giang, Bac Ninh and Quang Ninh provinces.

⁴⁵ Calculated at 120Yen/\$, the port (only) debt service cost per ton cargo using the port is \$2.58, assuming 100% utilization. This figure will vary, of course, depending on actual utilisation and the prevailing Y/\$ exchange rate. Debt terms are for OECF concessional lending are 2.3% (on Yen) with ten year grace period and 30 year repayment.

Form an employment perspective, the Cai Lan will not employ as many workers as hoped. The Ministry of Construction Masterplan for Ha Long indicates that some 35,000 people are expected to be employed by the Cai Lan by the year 2010. However, in a modern container port, like the one envisioned for Cai Lan operating at a throughput of 15 million tons per year, direct and indirect employment will not exceed 10,000.⁴⁶ Actual demand for cargo at the port and hence labor of even 10,000 will not be reached until well after 2015.

Bridge

The proposed \$100 million Bai Chay-Hon Gai suspension bridge raises serious questions about the ability of government (at all levels) and foreign donors to carry out careful project selection. While the costs of the project are quite clear, its justification is still subject to discussion.

Planners argue that if there is to be a deep-water port at Cai Lan, then a suspension bridge will be required in order to promote the free transit of shipping and traffic. From an economic view, the benefits of the project are not so clear, however. The bridge, if pursued as currently planned in conjunction with other infrastructure projects, will not have as many benefits as envisioned by planners in government and much of the donor community.

The suspension bridge is designed to connect to the top of a hill on the Bai Chay side, to the top of a hill on the Hon Gai side of the channel. Both hilltops are currently unoccupied by residents and support no economic activity. Because the hills on both sides of the channel are very steep, the suspension bridge will require long, high approaches. As a result, the bridge will be of little use to local traffic directly on either side of the channel.

However, it is by no means clear that anything other than local traffic will require cross-channel transport. Other infrastructure designed to support Cai Lan port will carry all of the inter-provincial passenger and container traffic that is planned.⁴⁷

Without inter-provincial demand for vehicle traffic, the economic benefits of any bridge across the channel will rest solely upon the amount of time that the bridge saves local residents and how much they are willing to pay for it.

Local traffic presently has two different ferry options across the channel. The passenger/bicycle ferry moves passengers across the channel with a total travel time of ten minutes (including waiting). Cost is 500D per passenger. The larger ferry moves passenger/large vehicles across the channel with a total travel time of 20 minutes (including waiting). Cost is 500D for people and 5000D for cars.

It is unlikely that pedestrian or bicycle traffic will save any time by using a bridge with one-km approaches on either side. Motorcycle and local car traffic will likely

⁴⁶ Hai Phong currently has a capacity of 5 million tons per year (mostly general cargo) employs 5,000 people.

⁴⁷ The proposed Rte 18 is designed to carry future traffic around the bay, bypassing Ha Long City and going directly to the Cai Lan Port.

save time by using the bridge (estimated 50-75% time savings), but the volumes associated with local vehicle traffic may not justify the \$100 million investment.

Rather than invest \$100 million in this project, it might be more sensible to explore alternatives. For example, a 500m drawbridge, with short approaches, might be better suited for Ha Long City and the limited traffic associated with the Cai Lan Port. Total costs for a drawbridge might be only \$30 million. While the occasional ship will cause traffic to be delayed, total average travel times for passenger/bicycle as well vehicle traffic will be considerably shorter than total travel times associated with a suspension bridge.

Foreign Investment

Unlike in Hai Phong, FDI has not played an important role in Quang Ninh's economy. During 1998, the city has licensed 17 FDI projects with \$237 million in capital. Since 1989 the province has attracted a total of 34 investment projects worth \$832 million. However, realisation of investment has been quite low, only 15% of total capital to date. Also, 9 of the 17 projects licensed this year (65% of the total capital) have already either been postponed or have had their licenses withdrawn. These figures give an indication of investors' feelings about the general business climate in Quang Ninh.

While local authorities complain that they do not have enough capital to participate in joint ventures with foreign companies, they seem hesitant to allow 100% foreign firms to operate in the province. Quang Ninh has attracted only three 100% foreign-owned projects (only 1.25% capital of the FDI sector). In comparison, 73% of all foreign investment in Dong Nai Province is 100% foreign-owned.

Like Hai Phong, Quang Ninh would like to use foreign investment in order to develop its heavy industries (See Investment List). Two of the three planned phase one cement projects were to have been undertaken with foreign financing. Unlike Hai Phong, Quang Ninh seems to have 'limited' foreign investors to the heavy industry sectors.

There are relatively few investments in the tourism sector. Tourist sector investments are limited to only two hotels, one beachside entertainment area and the large-scale Tuan Chai Resort.⁴⁸

The recent withdrawal of investment capital will provide Quang Ninh with the same opportunity to reassess this strategy as Hai Phong. Quang Ninh, like Hai Phong, may want to refocus its attention to concentrate its medium term resources on the most dynamic sector in the province. In the case of Hai Phong, the dynamic sector is the shoe export sector, private sector manufacturing shoes in particular. In the case of Quang Ninh the dynamic growth sector is trade and tourism associated with China. A realignment of strategy and priorities will encourage development of this dynamic sector with supportive policies and action.

⁴⁸ Estimated to cost \$300 million. Foreign investors have not been identified or licensed, yet.

Mong Cai Border Zone

Since the border was opened with China in 1989, economic growth in Mong Cai has been very rapid. The border town in northern Quang Ninh was granted the status of an experimental Border Zone (675-TTg) by the central government in September 1996. Average annual economic growth over the five-year period from 1991-1996 was reported to be 36%. Average annual economic growth in 1997-1998 is estimated to be in the range of 15%.

When the border was opened in the 1989, 80% of the district's total economic activity was in agriculture. The composition of economic activity quickly shifted to reflect the new comparative advantage of the area. Trade, tourism and services currently make up 72% of all economic activity. The total volume of trade between Mong Cai and China in 1997 was \$300 million (2/3 of that number were exports to China). Agriculture has fallen to 20%. Per capita GDP in the district is now \$420, nearly double the provincial average level.

The importance of trade is evident in the town. There are 300 businesses and 85 representative offices of Vietnamese businesses in Mong Cai. Mong Cai has more than 265 registered private companies and 1,756 household businesses.⁴⁹ Private companies in Mong Cai represent 95% of all the private companies in the province. It is not an exaggeration to say that outside of Mong Cai there is no private corporate sector in Quang Ninh.

Given the rapid economic growth and the obvious economic opportunity, it is not surprising that Mong Cai's population has been growing rapidly. At the time of border opening, Mong Cai's population was only around 20,000. It now stands at 55,000 official residents plus 10,000 additional unregistered inhabitants. This rapid growth in population has put strains on urban planning and zoning, but the local authorities seem to coping very well.

Most of the migrants to Mong Cai have been internal migrants from the coal producing areas of Cam Pha and Cua Ong. The prospect of trading opportunities and very cheap land lure them to the border town.

The Chinese and Vietnamese allow visa free travel for residents, though the Chinese authorities require Chinese who are not part of a tour to return to China by 5:00PM. This open border has resulted in a fast growing tourism industry in Mong Cai. There are now over 25 tourist companies in Mong Cai town serving Chinese tourists. The Tra Co beach coastal area claims that 90% of its local economic activity is directly related to the tourist industry.

Because of its remote border location the Vietnamese government offers incentives to businesses (foreign and domestic) that invest there. These incentives include tax waiver and reduction in corporate income taxes for eight years and fifty-percent reduction in land rents. Foreign investment has been limited to one taxi company and

⁴⁹ 675 Committee, Mong Cai.

to a single hotel (not yet constructed). Local authorities blame the temporary nature of the 'experimental' Border Zone status as the main reason why they cannot attract more foreign investment. If their status were made somehow more permanent, they feel this might ease investor concerns and encourage investment. Local officials expressed a clear preference for export oriented light industry over heavy industry.

More important than investment incentives, the central government has allowed Mong Cai unprecedented fiscal authority. The border status allows the district government to retain 50% of the taxes collected there.⁵⁰ The local budget jumped from 10 billion dong annually to 100 billion in 1997 and about the same for 1998.

The funds kept by the district government are used to develop infrastructure to support the rapid growth of Mong Cai Town. This includes the development of route 18A, connecting Mong Cai with Cam Pha and Ha Long city. On this route, Mong Cai authorities have invested 25 billion Dong to upgrade bridges and river crossings. Local authorities have also used these funds to upgrade local infrastructure and develop the town's infrastructure (water, electricity, roads) in order to deal with the towns rapid population growth. Local authorities in Mong Cai have undertaken a total of 33 different infrastructure projects worth 107 billion Dong.

Mong Cai Infrastructure Investments	
	Bill Dong
Transport	51
Electricity Distribution	14
Water/Sewage	11
Markets	13
Other	17
Total	107

As part of the two year review since the creation of the Border Zone, local authorities have warned themselves against gold-plating infrastructure investments and are looking for ways to meet real infrastructure needs while reducing total cost.

While there a series of incentives and preferences granted to the Mong Cai Border Zone, Vietnam has not instituted any trade-related preferences for the Border Zone. This is in spite of repeated requests by the local government to do so. This has been a point of contention between the local authorities and the Ministry of Trade, which has not been supportive of increasing trade-related preferences for Mong Cai.

It needs to be emphasised that much, if not all, of the growth in Mong Cai can be attributed to pro-trade policies on the Chinese side of the border. For the next few years Mong Cai will continue to benefit from favourable policies from the Chinese side. For example, goods brought into China from Mong Cai receive special import

tax reductions from the Chinese side as a way of promoting trade in that region of China. In addition to the official trade, there is a healthy and profitable business of smuggling (or in-transit) goods from Vietnam into China. These goods, mostly cars

⁵⁰ Across the border in the Chinese town of Dongxing, local authorities are allowed to keep 100% of taxes collected at the local level.

and cigarettes are transhipped through the Mong Cai port into China. This trade, while legal in Vietnam, is highly vulnerable if enforcement improves on the Chinese side.

In order to maintain the growth and development of the Mong Cai border area, it is critical that the central government considers further decentralization and flexibility for Mong Cai. Certainly the lessons of China's experience with Special Economic Zones has been that these zones would not be successful without decentralization of authority and responsibility to the local level.

Mong Cai district officials, with the support of the Quang Ninh provincial government, have requested that the central government provide them with special status as a 15km "Free Trade Zone" along the border⁵¹. Within such a zone, there are to be no trade taxes and even greater decentralization of authority. By creating an "export processing zone" atmosphere within 15km the border, it is hoped that Chinese businesses will consider moving processing activities to the Vietnamese side of the border. While this proposal is currently under consideration, local authorities have already set up 'border gates' at the 15km mark and carry out routine inspections of trucks moving past that point. The district government has also set up two large trade staging areas at the 15km in anticipation of central government approval.

Local officials hope that creation of the 'Free Trade Zone' will encourage Chinese entrepreneurs to come across the border in order to set up processing facilities and light industry for export. In the view of local officials, creating conditions that lead to the development of private/foreign sector light industry is of the highest priority in moving Mong Cai up the development ladder.

Local officials also have a keenly competitive spirit. They are aware that other provinces with better infrastructure, for example Hai Phong, are proposing to establish 'Special Economic Zones'. The continued success of Mong Cai will depend on making improvements in physical infrastructure, as well as the policy infrastructure that supports trade and investment. Without better policy infrastructure, growth in Mong Cai may slow or stop altogether as Chinese policies change and other towns in Vietnam are able to get preferential policies.

⁵¹ The Ministry of Trade proposed creating a "Free Trade Zone" two years ago on the Vietnam-Lao border. Local officials know this and argue that it will be difficult for the Ministry to oppose something that it already officially supports.

Conclusion

Development of industry and trade in the study area is a decidedly mixed picture. On the one hand, provincial authorities have expressed preferences for investing in developing large-scale heavy industries. In the current period of constrained resources, making the preferred industrial development plans of both provinces a reality is a remote possibility.

Even if it were possible to actually finance and develop the projects that the local authorities in the study area are promoting, benefits in terms of employment, exports, competitiveness associated with the preferred strategy are limited. Government policies to provide guarantees to commercial projects with poor economic fundamentals and to take on large amounts of sovereign debt from bi-lateral donors to support the present development strategy must be reassessed.

The preferred industrial development strategy by definition employs few people, does not export and will find it difficult to compete at international prices. This is of critical importance since the biggest issue facing local authorities in Quang Ninh will be unemployment. Unless they are developing a workable and realistic strategy for dealing with unemployment then the future will look grim.

On the other hand, the picture in both provinces is not entirely bleak. Both provinces have dynamic sectors that are responsible for providing economic growth, exports and jobs to a growing sector of the population. In Hai Phong, the shoe and garment industry, particularly the private sector, has been growing rapidly in spite of the regional downturn. In Quang Ninh, border trade with China, through Mong Cai has been the dynamic sector.

A realistic industrial development strategy will be one that builds on the dynamism in the economy not one that attempts to develop in spite of it. Over the medium term that means Hai Phong should support and promote the continued development of private sector manufacturing through improving access to credit and reducing bureaucratic obstacles to the rapid development of a corporate private sector. Quang Ninh should actively promote its trade based ties to China and find ways to lower trade and investment barriers between China and Vietnam, this will likely include infrastructure (road) upgrades between Mong Cai and Ha Long.

In both cases, there is a strong argument to be made for aggressive tourism marketing efforts, though each with a different target consumer. Hai Phong will likely do better with Vietnamese tourists, while Quang Ninh is in better position to capture the Chinese tourists.

A strategic approach to industrial development in the study area might look something like the following:

- 1) Hai Phong continues to play the central role as provider of transport and port services throughout the North. Continued development of the private sector leads to growth of light industry for export, particularly in shoes and garments. "Special Economic Zone" status may promote further development of light industry and the private sector. Local government and foreign sector focus on upgrading port

facilities in order to support growing demand. Improved transportation links between Hai Phong/Do Son and Cat Ba Island increase the potential for tourism in Ha Long Bay.

- 2) Dong Trieu/Uong Bi will take advantage of organic growth along Route 5. Upgrading connections between this area and the Rte. 5 corridor will create opportunities to develop light industry. Upgrading infrastructure connections between Dong Trieu/Uong Bi and Rte 5 will help include this area into the economic life and activity of the northern Red River Delta. Allowing light industry to develop here will be critical if local authorities are interested in reducing unemployment for redundant miners and their families.
- 3) Mong Cai on the Chinese border will continue to play a very important role in developing trade with China. Mong Cai can take advantage of its beach areas in order to expand possibilities as a destination for Chinese tourism. If Mong Cai is able to get "Free Trade Status" status in a 15km radius of Mong Cai town, then there are opportunities to develop processing industries for export to China and beyond.
- 4) Cam Pha will continue to be dominated by coal and the coal-related sectors for the near future. The coal sector will likely add little incremental growth to Quang Ninh into the future. In employment terms, the coal sector will lose jobs as it seeks to become more efficient and competitive. Unemployment will become an increasingly important issue in this region.
- 5) Ba Che/Tien Yen/Quang Ha are among the poorest districts in Quang Ninh Province with high percentages of minority people's. There are opportunities to raise income through tea growing, but suitable land is limited. Industrial and trade development in other areas of the province may create income-generating opportunities for residents here.
- 6) Ha Long Town will not likely become a major destination for light or heavy industries. Port services will not likely play an important role in incremental growth. Rather, Ha Long Town may find itself relying exclusively on tourism and services for future growth. In tourism, Ha Long can focus its tourism services in order to cater to Chinese tourists. In other tourists markets, Ha Long will have to increasingly compete with Hai Phong for tourists. Ha Long may benefit from some of Mong Cai's China-based tourism and trade success if Quang Ninh completes an upgrade of Rte18A between Ha Long and Mong Cai.

Appendix: Central-Local Dynamics

There are an important series of dynamics at work between the central government, the provincial government and the donor community in the study area. The issue with the most obvious implications for investment planning and development surround the problem of over-centralization of fiscal authority.

Over-centralization of fiscal authority leads provincial government to pursue a 'big budget' approach to development. The central government rationalizes centralizing budgetary allocations by stating that local governments do not have the capacity to carry out efficient selection and preparation of investment projects. In fact, current systems and incentive structures do not reward provincial governments for good project selection. As a result, they tend to create wish-lists in order to submit to the central government.

Since large-scale investments are often the responsibility of central government organizations, and not local governments, local governments are indifferent as to the efficiency of the investments.

Projects sponsored by central government organizations, be it the General Cement Corporation or VINACOAL, have no apparent downside for local authorities. As a result local authorities encourage as many as possible large scale central government projects as possible.

This is also true of foreign invested projects where the government has provided bank guarantees. By eliminating the commercial and exchange risk, foreign investors are encouraged to finance projects with dubious economic fundamentals. Such is the case in Quang Ninh with regard to the Lang Bang Cement plant which it to receive a government guarantee.

Unfortunately, even if local authorities know that investments are not efficient, the most rational behavior is to support bad projects. The costs seem to be dispersed (borne by the whole country, not the individual province) while the benefits are concentrated (on the workers in the plant or building the project). Under those circumstances, who could say no to a grand port scheme or a brand new highway?

One of the reasons why Investment Lists, often put out by provincial governments, are so grandiose is because they understand exactly that only under very special circumstances are the resources at stake truly their own. Financing will come from the central government, some outside agency or a foreign investor. Rarely will local authorities be required to pay the actual cost of using these scarce resources.

A block grant approach to government spending and more decentralization on the revenue side would alter these incentives and encourage more appropriate project selection and more efficient use of funds. The experience of Mong Cai shows that this is true.

While it has been difficult for them to manage, they are now controlling most of their own expenditures and are making prudent and reasonable investments. More than

that, there is an obvious concern by local officials about the quality of their investments.

Another area of central-local friction is a differing in direction over development priorities. In many cases, the central government is simply not in touch with actual development needs at lower levels and simply imposes its own view on lower levels.

Here it is instructive to look at the example of Mong Cai. The central government, Ministry of Trade and Ministry of Planning are hesitant to allow Mong Cai trade preferences. This is informed by economic and political concerns about increasing dependence on China for economic growth. The fear is that if Mong Cai were to get preferential treatment than other provinces would also demand the same treatment and somehow the central government ministries would lose control of the border areas.

From Mong Cai's point of view, the objective function is increasing economic activity and thereby incomes for its people. The end to its isolation and poverty lies in more trade and investment with and from China. It understands that this can happen only with additional trade reforms and easement of top-down control.

Hai Phong has made the same arguments over the establishment of a Special Economic Zone there. Dong Nai has also made the same arguments over further decentralization of decision-making authority there.

Another example of the same conflict can be seen in Hai Phong. The Northern Growth Triangle is considered to be an important economic and political development objective. The central government sees this as an important economic area. Unfortunately, Hai Phong has not bought into this concept, yet. As far as Hai Phong is concerned its future lies with the Red River Delta. The first page of the Economic Development Strategy of the city makes this clear.

While the study area did not have an opportunity to discuss the Growth Triangle concept with Hanoi city officials, it would be surprising if they saw the future of their city more closely aligned with Quang Ninh than with Red River Delta provinces like Nam Dinh.

*Appendix: Poverty in the Study Area*⁵²

While the study area has long been a center for industrial activity in Vietnam, it remains very poor. Most of the mountainous districts in Quang Ninh report extreme poverty. For example, Ba Che District in Quang Ninh reports an average annual income level of approximately \$30 per capita. Other districts have slightly higher levels of income (Binh Lieu District: \$45 and Tien Yen District: \$60).

At the same time, income disparities between districts can be quite large. Per capita income in Mong Cai Town, for instance, is \$420, seven times Tien Yen District and 14 times Ba Che, Quang Ninh's poorest district.

The poorest regions in Quang Ninh Province are sparsely populated mountainous areas with high proportions of minority peoples. It is highly unlikely that there will be development of industries at any scale in these areas. At the same time, populations in the poorest areas are not very mobile. For example, Ba Che District lies midway between Ha Long City and Mong Cai Town, but yet there is very little reported migration to the higher income areas from Ba Che. At the same time, the Cam Pha and Cua Ong coal centers are the sources of most of Mong Cai's new residents.

Dealing with poverty in Quang Ninh will then have to take into account two very different populations of poor people. Each will require a different strategy. One group is the semi-urban poor now working in the coal sector. For them, there are opportunities in Mong Cai (trading and possibly light industry), Ha Long (if tourism is given proper focus) and possibly in Dong Trieu in light industry (if proper policies are in place).

The second group, the isolated poor in Quang Ninh's poorest districts will require extensive direct assistance. This group may not see any benefit from the economic successes of the urban and semi-urban areas.

Poverty Levels⁵³

District/Town	# Poor families	% of Population
Ha Long Town	2,885	7.9%
Cam Pha	3,109	10.32%
Uong Bi	2,514	14.13%
Mong Cai	3,338	30.18%
Quang Ha	3,207	23.52%
Tien Yen	2,969	43.75%
Binh Lieu	2,405	58.81%
Ba Che	1,822	66.66%
Van Don	3,174	48.12%
Co To	282	52.22%
Hoanh Bo	1,472	14.11%
Yen Hung	3,065	12.05%
Dong Trieu	8,167	25.12%

⁵² Chuong Trinh Xoa Doi Giam Ngheo, 1998-2000, People's Committee of Quang Ninh, March 1998.

⁵³ Poverty in Quang Ninh is defined as having less than 14.5kg of rice or 45.000D in cash income per month per family.

Appendix: Dong Nai And Quang Ninh: Investment Policies

Dong Nai and Quang Ninh are both corners of Economic Growth Triangles. Quang Ninh lies on the easternmost edge of the Northern Economic Growth Triangle and Dong Nai lies on the northernmost edge of the Southern Economic Growth Triangle. When the Economic Growth Triangle were established, both provinces started from an almost equally low industrial level. Quang Ninh was the center of Vietnam's coal industry, but aside from that had very little in the way of industry. Dong Nai, on the other hand, started with little in the way of natural resources, but a single 'industrial zone'⁵⁴ that had a number of inefficient enterprises producing little of any economic value.

However, five years after the creation of the Growth Triangle Concept, Dong Nai is well on its way to industrialization, while Quang Ninh is still trying to find its way to the starting gate. Though there are many reasons for the vastly divergent development paths of the two provinces, one important reason is provincial investment policies and provincial attitudes towards investment.

Basic status before 1994

	Dong Nai	Quang Ninh
Location	North East of South	North East
Important neighborhood	Ho Chi Minh city Vung Tau	Ha Noi (150km) Hai Phong China
Population	1.9 million urban: 26%	0.9 million urban: 43%
Natural resource	- Lime stone, clay, sand - Fresh water - No sea coast	- Coal (3.5 billion tons) - Lime stone, clay, sand - Limited fresh water - Long sea coast (250km)
Industrial base and infrastructure	- Good road system - Bien Hoa IZ (before 1975)	- Ports along the coast - Coal mines
Main industrial products	- Steel, machinery, paper...	- Coal (domestic and export) - Mechanics for coal industry
Tourism		- Ha Long Bay - Tra Co Beach

Looking at the masterplans of the two provinces, advantages and disadvantages are very clear. Quang Ninh has a much stronger natural resource base for industry and trade. Dong Nai has no significant resources and with regard to trade it has no ports or direct connections to large international markets. Nonetheless, Dong Nai is, without question, the stronger of the economies.

Some argue that Dong Nai had a good industrial base prior to reform and was destined to do better than Quang Ninh. Others argue that it was natural that investment would flow to Dong Nai so that it could have easier access to Vietnam's largest market, Ho Chi Minh City.

⁵⁴ The industrial zone concept was created during the American involvement in Vietnam. The zone concept provided an easily defended concentrated area. As a result, Dong Nai's early zone made military sense rather than economic sense.

However, the industrial base in Dong Nai was limited to the Bien Hoa industrial zone. The Zone was occupied by state-owned enterprises with obsolete technologies operating inefficiently. The contribution of industry, and these enterprises, in particular was extremely small. The Ho Chi Minh City market turns out to be not the main draw for investors in Dong Nai. Over 65% of new investment in the province is export oriented and not focused on Vietnam.

One might expect that light industry, particularly shoes and garments, follows cheap labor. However, the data show that clearly investment in industry continues to come to Dong Nai, in spite of the high cost of labor relative to labor costs in Quang Ninh.

<u>Monthly income of labor in state sector</u>	<u>1995</u>	<u>1996</u>	<u>1997</u>
Dong Nai (Average growth: 23.7%)	332,000	415,000	508,000
Quang Ninh (Average growth: -0.7%)	280,500	281,300	277,100

Income per capita in 1997

North East of South (including Dong Nai):	275,340 dong/month
North East (including Quang Ninh):	132,360 dong/month

So even for light industry, there are other more important factors besides the cost of labor.

Rather than issues of labor cost, natural resources or location, policy and government has played the critical role in determining whether or not investment, particularly industrial investment would come to the province. It is here where the two provinces diverge markedly. In the case of Dong Nai, policy and government encouraged it, in the case of Quang Ninh, policy and government have discouraged it.

	<u>Dong Nai</u>	<u>Quang Ninh</u>
FDI projects	231	34
FDI registered capital (million)	\$4,370	\$832
Realized capital (%)	34%	15%
Number of Industrial Zone	9	1
FDI capital in IZs (million)	3,365	64

1. Light vs. Heavy industry

The master plans of the two provinces tend to reflect the biases of the Central government in favor of developing heavy industry. However, Dong Nai authorities make it clear that this bias is a central government bias and not one of the province. The provincial authorities placed priority on the development of light industry over heavy industry while allowing that the central government (and others) might want to pursue heavy industry projects.

	Scenario 1	Scenario 2
Dong Nai	- Develop light industry	- Priority for light industry - Develop heavy industry and high-tech industry
Quang Ninh	- Until 2000: upgrade existing industry, avoid capital intensive investment - After 2000: develop new capacity	- Until 2000: Fast develop heavy industry: cement, steel... - After 2000: concentrate more on quality than quantitative growth

Quang Ninh's Masterplan recognizes two possible development directions. In the 'constrained' case where resources are not coming from the central government, the province will make do with modest upgrades of existing infrastructure and develop light industries that are not capital intensive. In the 'unconstrained' case, investment resources are available from the central government and a number of heavy industry projects can be pursued, including cement, steel and shipbuilding. One obvious problem is that the local authorities have not seemed to recognize that they are currently in the 'constrained' resources scenario.

In the case of Dong Nai, local authorities have focused on the development of an investment framework. Within that framework, any investment, light or heavy industry is encouraged provided that it creates more jobs and is in line with current environmental laws. In Dong Nai there is no list of 'preferred' investment projects.

Quang Ninh is very different. There local authorities prepare a list of projects calling for investment which clearly presents all project parameters, including product, location, Vietnamese partner, size and capital required for each project. While the list may reflect the interests of provincial government planners, it does not necessarily reflect interest of investors (foreign or domestic). On the other hand, the list framework may arbitrarily deter investors who have projects with different parameters and goals.

The FDI results in Dong Nai better reflect the direction and interests of foreign investors who understand international market conditions. For instance, though the central government is encouraging it, there are currently no cement projects in Dong Nai.⁵⁵ There no new steel projects since investors understand that steel is over-supplied in both domestic and regional markets and would not be a profitable investment.

2. Industrial Zones

The experience from Dong Nai reveals that siting industrial zones close to large population centers is a critical factor in the success or failure of an IZ. For example, Nhon Trach 1,2 and 3 have received less investment than other zones and they happen to be the furthest away from towns and population centers.

⁵⁵ This in spite of the fact that the province has limestone and clay and right next to the huge construction markets of Ho Chi Minh City and Vung Tau.

That experience may help planned IZs in Quang Ninh. Industrial Zones set up far from adequate supplies of good labor will fail especially those that aim at modern or high-tech industry.

Appendix: Fishing Industry in the Study Area

The study area is one of four main fishing grounds in Vietnam. It has a vast coastal area suited for fish, shrimp, and shellfish farming. The quality of water is generally very good and labor costs are very competitive. The waters around Ha Long and Bai Tu Long, including the islands of Cat Hai and Cat Ba, are rich in sea products with high value. Bach Long Vi Island, which is located mid way between Hai Phong and Hainan Island of China, is regarded the best fishing ground in the Eastern [South China] sea.

The fishing industry in the study area has ports with shipping and catering services, which have been accommodating fishing boats for years. Cooling and freezing facilities in Hai Phong have long been established to serve as both distribution and processing center for the industry for export and domestic markets.

The markets for the local fishing industry are not limited to the local population of 2.6 million. While Hai Phong benefits from a good transportation network that connects it to the domestic market as well as international market, Quang Ninh is right next to a huge Chinese market for seafood. Since 1989, when border trade with China through Mong Cai gate resumed, this market has greatly expanded. At the border gate, the study team observed sales of fresh shrimp from Hai Phong and chilled fish from as far away as Thanh Hoa.

Despite huge potential, the fishing industry in the area has performed very poorly in the past years. In 1997, the fishing industry of Hai Phong employed about 31,000 workers, of which 18,000 were fishing, 12,000 were farming and 1,000 in processing units. The value of the whole industry was less than 4% of the city's GDP. Export value was USD 7.1 million in 1997, less than 1% of the Vietnam's total fisheries exports. Living standards of fishermen are among the lowest in Hai Phong. In Cat Hai district (which includes Cat Ba island), where the vast majority of the population works in the industry, 12.62% of the people are reported living in hunger. The comparable figure for Hai Phong area is 4.90%.

The situation for fishermen in Quang Ninh is even worse. In 1979, when the Chinese Vietnamese, who dominated the fishing industry here, left Vietnam because of the conflict between the two countries, the industry virtually collapsed. New local entrants have not been able to fill the gap because of poor fishing techniques and limited financial resources. The industry's share of GDP is now less than 1% of the province's total.⁵⁶ Currently the industry employs about 15,000 workers with 10,000 in fishing and the rest in farming. Many of those working in farming are part-timers. More than 50% fishermen are living in poverty and their children are grow up without attending school.

Fish farming in the coastal area is underdeveloped because of poor capital and technologies despite the abundance of mangroves that make it an ideal place for less intensive farming techniques. Hatching and disease prevention techniques remain at a very low level.

⁵⁶ This may also reflect the large degree to which fish are sold at sea to Chinese buyers offshore and never brought back to port.

Market information and contacts are added problems. Almost all exports of the area went to middlemen in Taiwan or Hong Kong before coming to European or Japanese customers. The majority of exported products are frozen or ice-blocked sold at low prices (fresh items command for much higher prices). Two state-owned factories dominate processing in Quang Ninh, with total capacity of 5 tons per day, employing 400 workers. In Quang Ninh only a small volume of only 50-70 tons of live fish are exported to Hong Kong annually.

Recently the government has decided to provide direct support to the development of offshore fishing. The Eastern Sea Program⁵⁷ makes preferential loans available for individuals and co-operatives to buy large horsepower boats for deep-sea fishing. Quang Ninh received VND17 billion and VND 22 billion in 1997 and in 1998. The majority (90%) of the money went to private individuals or co-operatives at a preferential rate of 0.81% per month and maturity of 7 years on non-collateral basis.

However, the financial support does not necessarily solve the problem of competitiveness. Many recipients reportedly lack of expertise. Fishermen in Quang Ninh report lack of profitability even with access to preferential credit. Fishermen also reportedly have difficulty in meeting the 15% co-financing ratio that is generally required for access to loans.

There are two obvious threats to the long-term development of the fishing industry in the study area. First is the threat to fisheries as a result of destruction of mangrove forests. An essential part of Quang Ninh heavy industry development strategy is large scale filling in of wetlands and mangrove forests on the flat coastal area. Plans for filling in mangrove forests are particularly aggressive in the area of Ha Long City. In other areas earthen roads connecting the mainland with isolated islands and peninsulas threaten to cut mangrove forests off from their water sources. There have apparently been no studies on the possible impact of this land-fill strategy on the fishing industry, though such studies are merited.

The second threat to the long-term development of the fishing industry is resource depletion in shallower waters near shore. In addition to damage being done to hatcheries and feeding areas associated with coastal mangrove forests, there is a threat lack of capital will concentrate all fishing resources in the shallow and near-shore areas.

Already the rapid increase in the fishing fleet in the study area has been concentrated in the smallest class vessels (20-40 horsepower). The pressure on the resources is clear. Fishermen are using electricity and dynamite in order to improve the size of their catches.

Clearly, there is an ample opportunity to develop the fishing industry into one of the leading sectors for the study area, in terms of employment and income. This is particularly true in the short to medium term as large-scale investments in heavy industries like cement, steel and shipbuilding and are not likely to materialise.

⁵⁷ Resolution No. 393 dated of June 9, 1997 supplemented by Resolution No. 159.

Small investments in farming technologies, encouraging private involvement, improving marketing techniques, will help the industry develop. In Quang Ninh in particular, it is evident that shallow-sea near-shore resources are in danger of depletion. Assisting fishermen get access to larger boats and move further from shore may reduce some of that pressure. At the same time it is imperative that local authorities investigate the impact of destruction of mangroves on the fishing industry.

Appendix: Ha Long Private Sector

The study team visited a private firm in Ha Long City that produces wooden furniture. The company was formed 6 years ago by a group of three young entrepreneurs. It has equity of one billion dong (US\$75,000) invested into equipment and a small plant bought from a now defunct SOE. Despite its very small size, it is well above the average size of private enterprise in Quang Ninh province.⁵⁸

The firm sees its strength is in customized furniture where it can complete a medium-size order within a week. Another strength is its good reputation in the local market. The firm imports material from Germany and provides a three-year warranty on all its products. The firm has a stable market share in households, offices and low-end hotels. Its annual revenue is about 2 billion dong.

The major weakness of the firm, according to its owners, is the age of its equipment. Because the equipment is so old (purchase secondhand), product quality suffers. The company is stuck in the low end of the market and limited to the Ha Long area. Furniture makers in Hai Phong make higher quality pieces and it is difficult for the Ha Long company to compete.

The biggest obstacle to future growth of the firm is lack of access to credit. The firm would like to upgrade its equipment in order to improve quality and better compete against other furniture makers in larger markets. Upgrading equipment will cost approximately \$30,000.

Despite the fact that the owners of the firms are quite satisfied to take on debt at current interest rates (1%/month), they are unable to get financing. Requirements for access to bank credit are very complicated. A loan from the bank requires collateral, in the form of land or cash.⁵⁹ Like many other private firms, this firm does not possess clear title to the land on which it works and therefore cannot qualify for collateral for a bank loan. If they could qualify, the loan would be limited to 70% of the value of the collateral, or just \$22,000, not enough for an equipment upgrade.

The firm would like to diversify its ownership and allow others to buy in and thereby increase its capital. However, it is currently too small to raise financing through a share issue as a joint-stock company, that requires registered capital in excess of 10 billion Dong.

The firm would be interested in financing its equipment upgrade through through a leasing arrangement. This kind of arrangement might the best fit for the private firm in Ha Long. However, leasing firms are not interested in providing finance to firms not involved in exporting because of concerns about currency convertibility.

The situation of similar firms in Hai Phong is not so desperate, however. The Council of Non-state Enterprises there provides assistance such as bank loan guarantees or access to credit through a credit cooperative for members. The Council also helps firms to develop or to resolve difficulties, organizes management training, and

⁵⁸ 426 million dong (1997).

⁵⁹ State Bank regulations require private firms to put up collateral in order to get a bank loan. SOE's are not required to put up collateral for loans.

arranges marketing campaigns. By working closely with local authorities on behalf of non-state enterprises, the Council reflects the needs of business and proposes solutions to government.

The Council of Non-state Enterprises in Hai Phong is very different in almost aspect relative to its counterpart in Quang Ninh. Rather than see its role as a support mechanism for private sector activities in Quang Ninh the Council there functions very much like a government organization tasked to manage and direct private sector activity. It is no surprise then that the Council in Quang Ninh is not very effective in promoting private sector activity.

Appendix: Hai Phong Port and Cai Lan Port

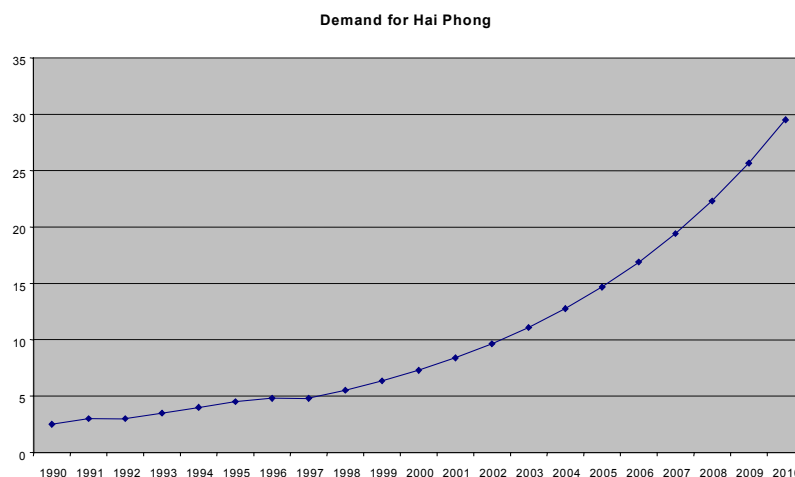
Hai Phong Port

For many years, the port has played a central role in Hai Phong's economic life. Not only has the port been the gateway to the world for Hai Phong, but it has also been the most important international gateway for all of northern Vietnam. The industrial development of the city has been closely aligned with the port.

The port in Hai Phong sits at the end of a well-developed transportation network, including Rte 5, Rte 10, railway, and waterways connecting the port with Ha Noi and the Red River Delta.

Current capacity of the port is 5.5 million tons per year (throughput in 1996 was 4.8 million tons). It is estimated that the port can be upgraded to a maximum capacity of develop to 8.5 million tons. Recently, developers have begun to build a new port on Dinh Vu Island at the mouth of the Bach Dang River. Dinh Vu Port has planned capacity of initially 2 million tons and eventually 12 million tons. Total planned port capacity in Hai Phong upon completion of both planned upgrades will be over 20 million tons per year.

If demand for port activities grows at annual rate of 15% (an optimistic scenario in current environment), then the current upgrading plans will be suitable until around 2010, when demand grow to be over 20 million tons per year. By the year 2010, practices and technologies may have improved to allow further expansions still.



The main constraint to the expansion of both Hai Phong Port and Dinh Vu port is the siltation problem in Nam Trieu area (at the mouth of the Bach Dang River). Despite costly dredging every year, the port can receive vessels up to 7,000dwt (or 10,000dwt reduced load). Engineers have been investigating this problem for years and have suggested a solution. They have recommended opening a new channel, the Trap Channel, which will allow the port to accommodate vessels up to 10,000 DWT or 30,000 DWT reduced load. The cost to open the new Trap channel is estimated at \$70 million.

Cai Lan Port

The Cai Lan port was proposed with two purposes. First, the port is in a natural deep water which can accommodate vessel up to 20,000 DWT now and 40,000 DWT in future. Second, the port was planned together with a strategy of the government to develop the Northern Growth Triangle. Quang Ninh will be an industry centers with concentration in heavy industry.

The development of the Northern Growth Triangle has been not very successful so far, particularly in Quang Ninh. The industrial zones in the area have attracted only two factories, a flourmill and an edible-oils bottling plant. Current demand for the Cai Lan port is less than 400,000 MT per year. There is no significant increase of demand seen in the future. Coal mining will likely remain the dominant industry in the area, and the industry has its own ports in Hon Gai, Cam Pha, and Cua Ong. Plans for development of industry in the area include projects such as steel and cement, which are now being delayed or cancelled.

The capacity of Cai Lan port is planned at 2,7 million tons per year by 2000 and 15 to 20 million tons per year in 2010.

However, demand for the port is unlikely to reach those levels anytime soon. If one were to assume steady growth in volume of exports of 15% per year (again an optimistic growth scenario), by the year 2010, when the port is expected to be 20 million tons of capacity, demand will have only reached 2.1 million tons. The only way for demand for the Cai Lan Port to grow any faster will be if there is a stop put to development and upgrades of the Hai Phong Port.

Port Choices: Upgrade Hai Phong or Develop Cai Lan

CAI LAN PORT AND HAI PHONG PORT			
Investment and Operating Cost			
CAI LAN PORT		HAI PHONG PORT	
Investment		Investment	
Port investment (first phase)	\$150 mil	Upgrade	\$80 mil
Highway 18 for heavy traffic	\$300 mil	Cai Trap dredging	\$70 mil
Railway to the port	\$300 mil	Other ungrade	\$100 mil
Total	\$750 mil	Total	\$250 mil
Incremental variable cost		Incremental variable cost	
Port capacity	2,500,000 tons/year	Total incremental thruput	2,000,000 tons/year
Local	500,000 tons/year	Goods handled at bay	15%
From Red River Delta	2,000,000 tons/year	Total handled at bay	300,000 tons/year
Extra inland transportation	50 km	Go directly by barge	30%
Cost per ton.km	0.07 US\$/t.km	Transit by lighter to port	70%
Cost per ton	3.5 US\$/ton	Lightering Volume	210,000 tons/year
Total cost	7,000,000 US\$/year	Unit cost for lightering	\$ 5.5 US\$/ton
		Extra loading/unloading	\$ 3.0 US\$/ton
		Lightering to port	\$ 2.5 US\$/ton
		Total cost	1,155,000 US\$/year

Developers of port services in northern Vietnam have two very different options for developing port services. Even with respectable growth in demand, these two directions are mutually exclusive. There is no way that demand can support the development of both ports simultaneously.

As a result, policymakers must choose which of the ports give priority in accessing scarce development capital.

There are several criteria that might be used in this decision process. Most important of all will be which port solution provides the best service and the lowest possible cost to Vietnam's manufacturing and trading sectors (the largest consumers of port services in Vietnam).

With regard to capital development costs, the Cai Lan complex is estimated to cost some \$750 million. This includes the development of the port itself, connecting roadway (Rte18b) and railway to Hanoi. There are opportunities to finance this complex using ODA from Japan and German bi-lateral aid. Once complete the port will have a capacity of 2.7 million tons (in 2000). Further investments will be required to upgrade the port to 14 million tons capacity (in 2010).

Upgrading the Hai Phong Port will require a maximum of \$250 million. Once upgraded, the port complex (including Dinh Vu Port) will be able to accommodate

ships up to 30,000dwt and will have a combined capacity of just over 10 million tons per year.⁶⁰

The big difference associated with the capital costs for both of these projects is the cost of the associated infrastructure that will be necessary for Cai Lan to be able to attract cargo and containers.

Issues about the capital cost aside there are two other important issues that should impact on the decision which port project to pursue. These are variable costs and shipping schedules.

If one assumes that the actual costs of shipping loading/unloading are the same from each location, then the incremental costs for Cai Lan Port are equal to the incremental cost of transporting goods to Cai Lan Port (an extra 50km). The incremental cost associated with the Hai Phong Port upgrade is equal to the cost of lightering (*definition*: discharge from main vessel to barge for transfer to port and unloading at port) cargo from an offshore anchoring bay to the port.

Transport costs in northern Vietnam are now in the range of \$0.07/ton/km. In order to transport goods an extra 50km from Ha Noi to Cai Lan, customers will incur additional expenses of \$3.5 per ton. If the volume shipped through this port is 2 million tons, then the total incremental costs associated with the Cai Lan Port will be \$7 million per year.

In the upgraded Hai Phong Port, 10% of cargo moving through the port will have to be lightered from an anchoring station. The cost of lightering this cargo will cost approximately \$5.5 per ton, or about \$1.1 million per year.

It seems clear that from both a capital investment and incremental cost point of view, the Hai Phong Port upgrade is the more cost effective of the two solutions.

However, one point of view that has not yet been taken into consideration is that of international shippers.

Planners assume that if a port is designed to accommodate large vessels, that they will come. In fact, the tendency in the shipping business is to increasingly use 'feeder' vessels and then consolidate cargo on to larger vessels in Kaoshung or Singapore.⁶¹ For example, Bangkok sends cargo via 'feeder' vessels to Singapore and Manila sends 'feeder' vessel to Kaoshung rather than send ships directly to export markets such as the US.

It seems unlikely that Vietnamese exports will be able to break the international shipping trends and force ships of larger sizes to call on Vietnamese ports. Sending large 'mother' vessels to Vietnam is extremely expensive when compared to the option of shipping goods via 'feeder' vessels to the 'mother' vessel.

⁶⁰ Phase One upgrade will raise Hai Phong Port to 8 million tons per year and Dinh Vu Port to just over 2 million tons per year.

⁶¹ 'Feeder' vessels average only 7-8,000dwt. Mother vessels average 25,000dwt.

As a result, if a deep-water port is built in Quang Ninh and if it is able to attract cargo, it is very unlikely that ships greater than 7-8,000 tons will call on the port with any frequency.⁶²

Along the same line of argument, if Cai Lan attempts to compete against Hai Phong, it may find itself at quite a disadvantage. The combined Hai Phong/Dinh Vu Port will be very attractive to shippers as the proximity of the ports to each other reduces the overall costs of picking up and discharging cargo in Hai Phong.

⁶² The plan calls for upgrading Cai Lan to receive vessels up to 40,000dwt.