

## PART THREE

# ***THE EXPORT PROCESSING ZONE AND VIETNAM AFTER THE WAR***

The first chapter presented an overview of the economic situation in Vietnam. In the second chapter, we have reviewed the development of EPZs and the operations of the Kaohsiung Export Processing Zone of Taiwan. The task now is to adapt the EPZ model to Vietnam. In other words, how are we going to create such a zone in Vietnam? What are the important issues related to this task?

The achievements of KEPZ are indeed highly impressive! Such a profitable "money-making machine" is something which all developing countries really need. However, one cannot just build an exact duplicate of the model and hope for instant success! In this chapter, we will focus on some salient issues facing us when the EPZ is introduced to Vietnam. These factors will be presented in three parts; namely, the building of a favorable investment environment, the preparation for the zone, and the management of the zone.

### **I BUILDING A FAVORABLE INVESTMENT ENVIRONMENT**

This is the first and probably the most important requirement which must be considered before any other steps can be taken. The factors, both controllable and uncontrollable, which greatly affect the investment climate are basically :

#### **A POLITICAL STABILITY**

Under the eyes of foreign investors, the safety of their capital will always be the first consideration in deciding to invest in any developing countries, including Vietnam. The success of a foreign investment program is thus largely determined by the level of political stability and in this regard, the Taiwanese experience is noteworthy.

The rush of foreign investors to Taiwan during the 1960s reminds us of the Gold Rush in the U. S. at the turn of the century. In 1960, only US\$36 million worth of capital was invested in 87 enterprises. In 1970, more than US\$560 million had been poured into over 1,600 enterprises! However, since 1971, for the first time in over a decade, foreign investment in Taiwan has fallen. In the first six months of 1971, only 70 investments worth US\$39.5 million in foreign capital were made in Taiwan, a drop of 38% compared with the same period in 1970.<sup>1</sup> The sudden drop was the result of the uncertainties surrounding Taiwan's political future during this period. Despite all reassuring efforts made by the American trade officials and despite the statement of the U.S. Secretary of State, William Rogers, that the U.S. Government would do all it could to retain membership for the Republic of China in the United Nations, potential investors as well as those with plans for expanding their activities in Taiwan were holding back to see what was going to happen. Companies which believe in the long term gain from the emerging trade with mainland China have postponed their investment plans in Taiwan due to the current policy of the PRC which prohibits companies trading with Taiwan or South Korea to do business with mainland China.

The development of new EPZs in Taiwan was greatly affected. The tremendous success of KEPZ was so encouraging that the government decided to build two more zones, one at Nantze and the other at Taichung. The Nantze Export Processing Zone was expected to find jobs for 40,000 workers in 200 export enterprises with a total investment of US\$30 million and to expand foreign trade by annual sales of US\$120 million. However, even though a first-class infrastructure of roads and factories has been provided, only 1,300 people have been employed on the site. Similarly, at Taichung Export Processing Zone where it was expected that 10,000 jobs would be provided, less than 1,200 workers have succeeded in finding employment.<sup>2</sup> Foreign investors have come to believe that it is better to settle for a smaller rate of return but in a safer and less political vulnerable environment, such as Singapore, Hong Kong and Malaysia.

With respect to Vietnam, the process leading towards a lasting peace has been very slow and painful. The immediate task is to build up a favourable image of Vietnam and a friendly relationship with other countries in the world especially in the Asia Pacific region. Looking

back at the four thousand year history of Vietnam, the one hundred years wasted under the French domination and the ensuing civil war was just a short span of time however the momentum of the growth in all fields of knowledge and achievements of the world have accelerated tremendously during the recent decades and we cannot afford to be left behind!

Contrary to the past when one country tried to dominate another by the use of military forces, the modern war is on the economic front and if wrong policies are adopted, Vietnam may fall into the perpetual trap of poverty and economic slavery which is not different from other forms of slavery in the past.

Whatever form of government after the war ends it is imperative that Vietnam should strive to be a good citizen of the world if its main objective is to improve the well being of its people. A good relationship with all other nations in the world as such is the key strategy in creating the favourable political stability which will then attract the economic assistance and investments to Vietnam.

## B AN ATTRACTIVE INVESTMENT LAW

Besides the political stability, the next important criterion is certainly the investment law, a factor which can be considered as controllable. Actually, there are many other aspects relevant to the establishment of a new zone, however the investment law is no doubt the prime consideration because it provides foreign investors with an indication of the national policy, and the attitude toward foreign investments, etc.

Except for the recent political uncertainties, the success of KEPZ was partly due to the fact that the investment climate of Taiwan was conducive from the very beginning. For a long time, Taiwan has, not only allowed foreigners to own 100% of their enterprises, but positively encouraged them to do so. Profit could be repatriated in full and after two years in production, a company could repatriate its capital investment at the rate of 15% annually. Moreover, a guarantee against expropriation was also provided. It was indeed the kind of incentives of which booms are made. The new investment law of South Vietnam, promulgated in April, 1972 to replace the previous one

enacted in 1963, has tried to give similar incentives. For example, enterprises with foreign participation are exempted from a variety of taxes, fees, dues, and customs duties for a period of five years after the initiation of operations. This privilege can be extended for another five years, and the government promises not to nationalize or engage in competition with these enterprises. In a sense, developing countries are competing with one another to attract foreign investors by liberalizing their investment laws. The question is whether it is reasonable and necessary to engage in such competition.

Unless developing countries can establish some kind of understanding among themselves on a common policy towards foreign investments, it is indeed an unwise move for one country to outbid another by offering more generous tax benefits. This competition might lead to a point where greater revenues will be sacrificed without any increase in the capital inflow to the country. Moreover, it has been found that the tax benefits have not played a significant role in attracting foreign investors. "According to a survey based on experience in Mexico before 1959, there was no instance in which tax exemption was a decisive factor, and in most cases, it was not even taken into account. Similar surveys in Argentina, Costa Rica, Jamaica, and the U.S. support this view and confirm the limited role of tax considerations."<sup>3</sup>

This view, however is still not universally accepted, and in the overall context, the policymakers should strive to formulate realistic and optimal investment incentives. An investment law must be carefully designed within the integrated national policy. What then are our ultimate objectives? And what are our strategies? Let us draw on the Taiwanese experience. In their case, someone might argue that her liberal investment law could be part of a strategy to "internationalize" the country in order to cope with the threat of mainland China trying to isolate Taiwan in the global arena.

A second key variable is the internal economic and social condition of a country. To what degree foreign influences be allowed to permeate and influence Vietnamese socio-economic fabrics. By leaving the door wide open to foreign companies, it is hoped that this method, if successful, will create a pool of local entrepreneurial talent. The foreign entrepreneurs will stimulate competition and imitation, and will provide opportunities for the local inhabitants to

acquire industrial techniques and management skills. This has been the pattern of growth found in many countries, but it is unlikely to happen wherever the gap between the technical and educational levels of the foreigner and the native are too large. Where the foreigner is greatly superior, he may become entrenched, and the local inhabitants will find it difficult to enter the field.

A well-intentioned but badly managed policy is dysfunctional and may create far-reaching consequences which might lead to future impasse. The country might soon find itself under another form of foreign domination - this time not military or political but economic subjugation!

### C A FAVOURABLE ENVIRONMENT FOR LOCAL ENTREPRENEURS

Last but not least, the government must encourage and inculcate the entrepreneurial spirit among local investors. This particular class of people are those who dare to take risks, to try out new ideas, and to venture on new projects. They are the ones who will serve as the bridge between foreign investors and domestic producers, and through joint ventures with foreign parties, the local entrepreneurs will be the conduit for the valuable transfer of technology and skills, the essence of the EPZ's policy. Without them, the zone will consist solely of foreign entities which will not impart much value to the local economy except for the use of cheap labour.

The Vietnamese class structure is still deeply rooted in traditional values. Merchants and entrepreneurs are still frowned upon by society. The majority of the population has been trained to believe that being an intellectual is the ideal in life and as such the entire educational system was geared up to the production of academicians. Those who do not make it to the academic stream and have to settle for the vocational or technical schools have always been looked down. The entrepreneurial spirit was stifled due to the belief that it is not desirable to pursue the profit motive. As a result, in the past, the Chinese community gradually gained control of virtually all branches of commerce and industry. This is a deep rooted problem which should be improved by a conscious effort of the government through various educational programs and special measures aimed at encouraging the

local entrepreneurs. Young people should not be fed with the ideas that their purpose in life is to study hard and get a stable job with good pay. Instead they should be encouraged to go out on their own, to start new business and be independent. A new model of economic heroes should be moulded and introduced through the printed media and public educational programs. For example, stories of successful Japanese business pioneers and their philosophies should be translated and disseminated and they should be invited to visit and give lectures in Vietnam etc...

While most of the above measures will only produce results in the long run, on the short term basis, the overseas Vietnamese community, who have been exposed to the foreign business practices and principles, can always serve as the pool of talents and capital for immediate use provided that they are convinced of the genuine desire and intention of the government. Similar to the overseas Jewish and Chinese communities, the mass of overseas Vietnamese represents a very critical energizer for Vietnam in the future. Special considerations, as such, should be given to attract them, their talent and their capital for the development of investment projects both inside and outside the EPZs.

## II PREPARATION FOR THE ZONE

Once the decision is made to establish an EPZ, there are a great number of tasks to be done. Within the limited scope of this thesis, we shall concentrate on just a few important points such as the location of the zone, the construction financing, the incentives to be offered, and the selection of exportable products and investors.

### A THE LOCATION OF AN EPZ

One of the first steps in building a zone is the selection of the site for construction. Based on the experience of Taiwan and South Korea, a good location should have at least the following characteristics:

1. **Geographical advantage:** The zone should be located in or near a port where big ships can enter, to facilitate the handling of goods and materials to and from abroad.

- 2 Availability of transportation facilities : In the case of KEPZ, inland transportation by both railway and highway connecting Kaohsiung with other big cities is extremely convenient, thus facilitating the transportation of domestic exports to the zone.
- 3 An abundance of labor supply in the surrounding area.

In March, 1965, the first EPZ of India was inaugurated at Kandla, 330 miles from Bombay, near the head of the Gulf of Kutch. The Kandla zone, however, was not a great success. More than 180 lots were available within the zone for plant development but even by 1971, almost six years after its completion, hardly a dozen units were operating in the zone. Kandla is a tidal port, and has been dogged by siltation problems. In addition, it was linked with Ahmedabad only by a meter gauge railway line. Many ships do not touch Kandla, and unless a minimum of 300 tons of cargo is offered, shipping space is not available.<sup>4</sup>

The problem of selecting a zone does not limit itself to the few basic characteristics cited above. The development of an EPZ must also be considered as the impetus to the development of a larger region surrounding the zone. With a number of, say, 40,000 workers involved directly in the zone, we should multiply by three or four to include their immediate families, and a whole new community has to be built to provide the supporting activities : markets, schools, hospitals, churches, the transportation network, etc... Furthermore, new local industries might be set up to produce goods for export to the zone. The selection of a site for the zone is thus a matter of great importance.

With respect to Vietnam, it was felt that some old U. S. military bases can be converted to EPZs, one of which is the Long Binh base, once the largest U. S. military installation outside the U.S.. This base covers 387 acres, is located 18 miles northeast of Saigon, 18 miles from the Tan Son Nhat International Airport, five miles from the Bien Hoa Airport, and three miles from the port of Long-Binh. The transportation network of Long Binh is very convenient. The base itself is a self-contained town with its own roads, water supply, power and sewage system, and telephone lines. Besides the good infrastructure, the base has hundreds of office buildings, warehouses, and housing complexes. Furthermore, the surrounding area has an abundant and

experienced labor force, formerly employed by U.S. military and civilian contractors and are, therefore, familiar with Western management philosophies and techniques.

On paper, it looks as if Long Binh is the ideal candidate. However, considering the long term effects of such a plan, there seem to exist several disadvantages : During the war years, hundreds of thousands of people from the countryside have fled to Saigon which is a more secure area. The population of Saigon and its immediate vicinity has increased tremendously during the last five years, and along with this have arisen all kinds of unsolved problems: pollution, public utilities shortage, lack of housing, overpopulation, etc. The building of a zone near Saigon will not lessen these problems but only make them more difficult to solve in the long run. Moreover, compared to many other regions in Vietnam, Saigon has already been overdeveloped. The priority of a zone location should be given to some other areas in order to achieve a well balanced development for the whole country. On the other hand, under the present situation, it may be a good idea to start with one such zone in the South as a test case since it will be much easier to attract foreign investors. Based on the experience of this zone, the second zone for the North may be developed at, say Hai Phong shortly afterwards.

## B FINANCING THE CONSTRUCTION OF AN EPZ

Even if Vietnam plans to convert some former U. S. bases into a new zone, the costs of building all the necessary facilities will be quite a burden for the government, especially when its balance of payments has already been in deep trouble for quite a long time. Again, let us look at what has been done at the KEPZ of Taiwan. The amount invested in building the infra-structure and standard factory buildings has totaled US\$7.7 million comprised of the following sources :

- 45% from the Sino-American Fund for Economic and Social Development.
- 25% from the Bank of Communication and the Land Bank of Taiwan.
- 30% from the Central Bank of Taiwan.



Finding sources of funds for the project is indeed an important task for the planners. One alternative is to look for some international institutions which can provide some sort of guarantee to the foreign investors with respect to the safety of their capital. We can look to the World Bank, Asian Development Bank, some Japanese and European development funds for this purpose. We believe that once the plan is underway, we will be able to get support from some of the allied countries of Vietnam in the world.

## C INCENTIVES TO FOREIGN INVESTORS

In this respect we will encounter basically the same arguments as in the case of the investment law presented above. However, the following basic steps can be considered in arriving at an incentives package.

- Review the kind of incentives offered at similar zones in Southeast Asia.
- Determine the extent to which these incentives have affected their success.
- Arrive at a tentative set of incentives, then modify them according to other constraints or requirements such as the national policy, the country's favorable geographical location, political stability, etc.
- Study the economic effects of these measures and the possible long term consequences on other activities. These are just a few basic steps. However, it might be interesting to note the fact that it is always easier to liberalize a law and grant more favors than to restrict or eliminate an existing one.

## D SELECTION OF EXPORTABLE PRODUCTS

How can we decide which products are acceptable for production in the zone and which are not? An obvious answer is the export potential and the amount of value added by the manufacturing process in the country. A decision cannot be made based on vague assumptions or superficial analysis but requires a careful study of all

related matters especially the experience from other EPZs in Asia especially the KEPZ.

## E SELECTION OF FOREIGN INVESTORS

The question raised here is not just on the financial capability, or credit rating of the prospective investors, but also on the importance of having a balanced portfolio of investors from different countries involved.

The investment downturn of Taiwan in 1971 was considered to be a consequence of the instability of its political environment. However, there was another important reason : Almost half of the total foreign investment in Taiwan came from the U.S., up to US\$250 million in 1970. The major impact of the downturn has not only been due to the cold relationship between Washington and Taipei, but also to the recession in the U. S. during this period.

Among the newly developed zones in Asia, the Korean Masan Free Export Zone (MAFEZ) also ranked high in the list of successful zones. Begun in mid-1971, after the first year of operation, it already housed 53 enterprises. However, officials at MAFEZ were frankly concerned about the extent of Japanese dominance in the zone. Of these 53 enterprises, 38 are owned by Japanese investors and 8 more are joint-ventures between Japanese and Korean investors, making the number of enterprises fully or partly owned by Japanese interests at 46. The rest are 4 U.S. investors, 2 U.S. - Korea and 1 Hong Kong.<sup>5</sup> (See appendix I for a listing of company, products and total investment at MAFEZ.) The reason for this Japanese predominance is the signing of the double tax treaty between Japan and Korea in March 1970 which enabled Japanese investors to enjoy the tax holidays provided by the Korean Foreign Capital Inducement Law. The success of MAFEZ was therefore dependent to a great extent on the bilateral relationship as well as the economic conditions of Japan.

Such domination is quite unhealthy! Consideration therefore should be given on whether there should be a restriction on the number or type of investors or on the amount of funds from any one country (if there is a choice!). Some of the consequences will just be unavoidable and this is once again another challenge for the zone planners to solve.

### **III THE MANAGEMENT OF AN EPZ**

Our discussion will be on the zone administration and the labor policy.

#### **A ORGANIZATION OF AN EPZ**

One of the serious obstacles which hinders the economic progress of less developed countries is the degree of red tape involved in almost all public matters. Entrance visas and residence permits are always difficult to obtain. Businessmen who are unwilling to pay bribes or to make the right connection have to wait up to a year. Business licenses are even harder to get, and exit permits - required by all residents wishing to travel outside the country - must be requested months in advance.<sup>6</sup> This situation does not necessarily happen only in Vietnam but it is a common phenomenon existing in almost any other developing countries. Getting back to the Kandla Zone of India, among the many things which are responsible for its limited success, one must include the difficulties arising from the multiplicity of authorities, and the lack of coordination among the agencies responsible for power, administration, port and other facilities.

The special organization of the zone and especially the centralization of authority to the zone administration is thus a necessary condition for a successful project. In this respect, the model of the Taiwan's KEPZ is an excellent example. Depending on the degree of control desirable, this structure can be modified to suit the particular needs.

#### **B LABOR POLICY ISSUE**

There seems to exist a growth pattern of labor policy at EPZs, especially at KEPZ and MAFEZ. At the outset, to ensure a strike free environment, very strict measures were imposed. For example, no serious strikes were allowed and all labor disputes in the zone were dampened by special laws. After a few years, improvements were gradually introduced such as the establishment of the Fifth Division in KEPZ and encouragement to unionize zone workers.

The labor problem is indeed a very sensitive issue, especially

in such a special place as an EPZ. One can imagine a community of, say, over thirty thousand workers at various plants who receive different packages of salaries and benefits offered by different employees. Due to the free flow of information between these workers, any new changes from the norm will certainly create disruptive impact on the whole workforce.

With respect to the issue of zone management, besides the two areas briefly mentioned above, there are certainly countless numbers of areas which can be discussed such as the foreign exchange settlement, measures to prevent smuggling, warehousing and transportation facilities, sanitation and health regulations, pollution control, etc. However, most of these technicalities can be adapted from the existing successful zones such as KEPZ, MAFEZ without much modification and copies of most of these regulations are provided in the Appendix for ready reference.

#### **IV CONCLUDING REMARKS**

From our discussion and lessons of experience drawn earlier, it is clear that the establishment of EPZs is crucial to the economic development plan of Vietnam. It took KEPZ five years to reach the US\$46 million investment mark, to provide jobs for over 40 thousand people and to bring back a sizeable annual earnings of over US\$31 million in foreign exchange. Given a favorable environment, with a comparable zone, Vietnam can expect to reap similar results in the same period of time or possibly shorter. The major obstacle, however, is still political. The future development rests on the resolution of the current impasse in the international relations between Vietnam and the western world. Unless a favorable relationship is established, all efforts in attracting foreign investment will bring little results.

What we can do now is to make the necessary preparations for such a zone to be built when the situation permits. For a start, detailed plans should be made; the future sites of the zone should be surveyed. The sources of funds for the construction work, prospective investors, profitable products, and potential markets, all of these must be carefully explored. Anyway, one should always keep in mind the fact that whatever is introduced to the EPZs will be contained within the four walls of the zone. One can always learn from past experiences and

mistakes to make further improvement. The EPZ offers an excellent controlled environment in which foreign investments can be introduced under the watchful eyes of the host countries. The benefits can be exploited while the negative impact curtailed or weeded out.

During the second take-off period of Vietnam, the role of an EPZ is indeed very important. In order to catch up with other more dynamic neighbouring countries in the Asia Pacific rim, EPZ is undoubtedly one of the most attractive and powerful developmental strategies to the policymakers and planners of Vietnam. The creation of an EPZ is not the panacea to all problems, nevertheless, with careful planning, many "linkage effects" can be achieved such as the training of a sizeable work force and the establishment of many related activities. Furthermore, the new zone can be used as a learning model for other governmental units outside of the zone. Its operations must therefore be integrated into an over-all large scale economic development program and must be coordinated with other important projects. All of these will be achieved some day and that day is certainly not very far away...

## References

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