

Path dependency, captive small suppliers and the race to the bottom: a tale of Vietnam's economy¹

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Abstract

The degree to which a latecomer country is involved in the globalization process of world economy has been long said to decide its catch-up success. Vietnam is by all means not an exceptional case. The country has been widely praised for its achievement to turn around from a Soviet-styled, ineptly blocked economy to a transitional, FDI-leveraged one, enjoying an amazing pace of gross domestic product (GDP) growth for years. Multinational corporation (MNC)-induced integration into global systems of value chain has brought Vietnam chances, along with challenges, to upgrade industrial capability. Initial resounding achievements generated by this critical restructure are evident, yet the country remains the situation of continued lag. Industrialization has significantly expanded in terms of quantity; however knowledge transfer and technology absorption processes are far below expectation.

This paper argues that Vietnam's current economic development strategy is path dependent trajectory of decline as the country is inclined to be ensnared into the situation of non-learning, labour-intensive assembling base of the region. Institutional, functional and cognitive lock-ins that hinder learning are conjectured to be the main internal impediments that result into an enduringly devastating, quasi-enclave situation where limited effective communication between MNCs and local small suppliers, between domestic and export sector as well as between state-owned and private business takes place. Vietnamese SMEs therefore have to race to the bottom to survive in such a MNC-dominated, captive value chain.

Keywords: path dependence, lock-in, FDI, small suppliers, value chain.

¹ This paper arises out of the first author's PhD project on globalization, supply chain fragmentation and consequent impacts on firms and industries in Vietnam endorsed by Chair of Business Administration, Production Management and Industrial Economics, University Bremen. The authors are grateful to University Bremen for financial support. The usual disclaimer shall apply.

I Introduction

The degree to which a latecomer country is involved in the globalization process of world economy has been long said to decide its catch-up success. Vietnam is by all means not an exceptional case. The nation's economic course of growth is foreign direct investment (FDI)-driven as multinational corporation (MNC)-induced integration into global systems of value chain has brought Vietnam chances, along with challenges, to upgrade industrial capability

Vietnam has been widely praised for its achievement to turn around from a Soviet-styled, ineptly blocked economy to a transitional, FDI-leveraged one, enjoying an amazing pace of gross domestic product (GDP) growth for years. The first phase of transition has been fairly doing well, leading to the mass inflows of FDI into the economy that helps to expand the country's hatchling manufacturing base. After 20 years of economic reform, Vietnam has recorded immense socio-economic achievements and eagerly goes for an ambitious goal i.e. to speed up industrialization and modernization process in order to bring the country out of the situation of being a laggard, turning into an industrialized country by 2020 (9th National Congress Documents - The Gioi Publishers - Hanoi 2001).

While we unequivocally appraise the astounding triumphs of the first period of transition, we very much doubt whether this objective is attainable insofar as in-progress policies have great propensity towards "a failing" state. The fact that FDI-led, export-oriented manufacturing in Vietnam still remains at the low-value added end of global value chains and of footloose character while tariff-protected, import-competing industry stays fragile severely challenges the nation's industrial upgrading efforts. A superficial look at neighbouring nations such as Malaysia, Thailand, Philippines and Indonesia appears to uphold our qualms. These countries have successfully leveraged FDI for economic development for decades. Such a thriving transformation from resource-based economies into low-cost, competitive export bases, however, does not pledge self-sustained growths. Among these nations, the so-called "de-linked industrial dualism" still dominates as effective export sector functions detachedly with feeble domestic production area. Additionally, more worsening external conditions to come as recent downturns in global electronics market, political volatility and China's emergence as new off-shore manufacturing platform have all in all curbed FDI inflows, trimmed MNC's existing operations and directed foreign firm's attention to much greener meadows (Felker, G. B., 2003). Suppose one is induced to ask, in this very circumstance, whether first-tier South East Asian nation's FDI-reliant industrialization is running out of stream, one should also question how Vietnam, as a late-developer and more or less pursues a closely analogous pathway, may escape from the apparently ordained outcome of low level trap.

In this perspective, we argue that Vietnam's present growth pattern is a path dependent trajectory of decline as the country is inclined to be ensnared into the situation of non-learning, labour-intensive assembling base of the region. Sustainable industrialization is, to our knowledge, extremely thorny to be reached if such an adjustment of economic course is not realized.

The rest of our paper is organized as follow: in section II, we seek to elucidate our suggested premise i.e. why, despite current significant accomplishments, the present implemented economic development strategy is path dependent. In

particular, we question the sustainability of the contemporary economic course, given that there are clear signals indicating the existence of lock-ins as the previous "good" path-dependent development tends to run exhaustedly, but without a subsequent corresponding decelerating feedback mechanism (Maskell, P. et al, 1998, p.66). The authors then endeavour to utilize the idea of institutional, functional and cognitive lock-in, originally coined by Grabher (1993) to show that hindrances to learning are the main internal impediments that result into enduringly devastating, quasi-enclave situation where limited effective communication between MNCs and local firms, between domestic and export sector as well as between state-owned and private business takes place. Finally, section III summarizes major conclusions.

II. Why learning is far from happening: the problem of lock-in

From central-planning to FDI-led, transitional economy: a path dependent trajectory of "good" transition.

Path dependence, also known as Polya urn processes, has been widely applied in describing situations where neoclassical theory seems to ignore: the "new" "positive feedback economics" rooted with increasing returns. In its original sense, path dependence challenges the classical economic view of technological choices that only the best products survive and lead market given individually maximizing behaviour of economic agents. As the famous QWERTY keyboard story suggests, due to random events, particular conditions of initial market and customer expectations, an early introduction of substandard products can produce a long lasting continuation as long as learning by doing/using effects and positive market externalities favour increasing returns to adoption. Positive feedbacks generated from both the choices of individual agents as well as the system as a whole bring about the lock-in of incumbent technology that entails immense switching costs that prevent any potential or even existing superior alternative taking up (for more details see Paul David 1995,1997; Arthur 1989,1994).

Economists are increasingly exploiting the idea of path dependence in analyzing the path of regional/national development. A country's development trajectory is very much shaped by not only past understandings, practices, decisions, historical events but also existing economic structure, institutional thickness, policy approved plus modes and types of present cooperation Gerhard Fuchs et al (2003) recognizes the important role played by institutions in the concept of regional development when proposing that, in addition to technology, regions are also affected by path-dependency.

Typical examples of path-dependent regional development are the often-cited Silicon Valley in USA and Germany's industrial area Ruhr. In the case of Silicon Valley, the co-evolution of technology and institutions triggered from the critical initial accomplishment-Fairchild Semiconductor-has been the main causes of continuation and reinforcement of the region's ability to renewal (Martin Kenney and Donald Patton, 2004). Regional decline of the Ruhr is, in contrast, described as a story of how a once unbeaten path of development of the industrial heartland of West Germany getting locked in its institutional thickness, and consequently led to bottomless economic catastrophe (Grabher, 1993). These two opposing cases has implied that, as Gertler, M. S. (2005) aptly puts forward, while some regions' early successes in technological/economic development, together with local

social, cultural and economic institutions, reinforce their prospects for sustained growth, ailing places may face a solemn intricacy to diverge from inferior path due to similar causes. Insofar as the two-sided implications of path dependency for regional/national development go, we should also note that “Path dependent systems – which have a multiplicity of possible equilibria among which event-contingent selections can occur – may thus *become locked in to attractors that are optimal*, or that are just as good as any others in the feasible set, or that take *paths leading to places everyone would wish to have been able to avoid*, once they have arrived there” (Paul A. David’ original expressions, emphasis added, 2000)

If we are to accept the fact “history matters” and that path dependency may be negatively and positively defined according to given context, we should also consider Vietnam’s shift from past central-planning to present FDI-led, transitional economy as a path dependent trajectory of “good” transformation and a manifest consequence triggered by gigantic institutional change. Path dependency, exploited in this approach, promises to yield insights into the preconditions of dynamic efficiency as non-egordic course of technological and economic change is very much shaped by the initial forms of the starting points of the process.

The transition is therefore path dependent in a sense that the systematically inefficient central-planning mechanism dominated in Vietnam economy before 1986, accompanied by inner demands of freeing up market and exhaustions of external resources of growth, have all in all pushed leadership to issue out the so-called doi moi (renovation) policy. In turn, Vietnam’s epochal restructuring of macro-economy prompted by doi moi policy in 1986 has brought about liberalization and openness of domestic market, de facto integration into regional and global dynamics as well as vast influxes of foreign capital and technology.

It has been so far a “good” development trajectory because the nation continues to grow at an unprecedented rate of development. Vietnam’s (GDP) growth rate scored 7 percent average in the course of five years between 2000 and 2004 and the expansion peaked out at 8.4 percent in 2005 (GSO 2005). These quite astonishing figures are, with little wonder, mainly attributed to the country’s success in attracting FDI given that Vietnam has been so far deemed to be a typically victorious example of a FDI-led transition economy (Dapice, O. David, 2003; Tran, 2004).

Since the first promulgation of the Foreign Investment Law in 1987-widely agreed as a liberal legal framework that shaped the foundation for Vietnam’s investment regime, the country recorded, up to the year 2002, as many as 4,047 approved licenses with total registered capital adding up to US\$ 41.5 billion. The ratio of realized investments over granted ones reached 57%, meaning that an amount of US\$ 22 billion has been already disbursed (Doanh, 2002). Although inward floods of FDI into Vietnam enjoyed a boom for only a short period of three years (1994-96) and the current investment upsurge just recovers at modest pace, it is hard to deny that FDI has came out to be the most important source of external resource flows that lend the country a bundle of means embracing not only capital but also manufacturing technology, marketing capacity, organizational and managerial know-how, etc.

FDI accounted for 25 percent of total investment on average between 1991 and 1995 with a slightly decrease to 21 percent for the period of 1996-2000 (GSO 2004). These statistics clearly show that foreign capital inflows indeed play

a critical role in pumping the thirsty economy, especially when one take into account that domestic saving rate has gone up at only restrained level of 16.0% of GDP in 1994, 27.4% in 2003, and 28.3% in 2004 whereas hatchling security markets, legal restrictions and a relatively inconvertible local currency prevent any significant foreign portfolio investment attempts.

Moreover, Tran (2004) notes that FDI has imposed a dynamic impact on Vietnam in a sense that “hard” and “soft” technology transfer as halo effect brought about by FDI projects, though not robust as expected, play a key role in upgrading Vietnamese fledgling industrial base. In terms of quantity, foreign sector made up 10 percent of total industrial output during early 1990s, escalated to a contribution of 25 percent in 1996 and reached 41.54 percent as for 2002 (GSO 2004). Doanh (2002) finds out that FDI has helped Vietnam, along with promoting major manufacturing industries such as food and beverages, garment and textile, to build up totally new industries such as oil and gas exploration and exploitation, automobile and motorbike industries. Some 300.000 workers have been trained or re-trained, 25.000 technicians and 6.000 managers have been educated, partially abroad. In addition, knowledge spill-over occurs as qualified people previously involved with foreign companies begin to set up spin-offs and entrepreneurial start-ups.

Major macro-economic indicators revealed above prop up the fact that the FDI-leveraged growth path Vietnam has adopted did grant great impacts on the country’s catching up process. The country emerges as a new promising production site endowed with an abundance of comparatively skilful, yet low-cost labour. This, in conjunction with an irreversible commitment to create FDI-friendly business environment, has helped Vietnam to increasingly integrate into regional dynamics as the country’s share of regional division of labour constantly swells. There are grounds to suppose that the country is on the verge of a new move as policy makers eagerly go for an ambitious goal i.e. to speed up industrialization and modernization process in order to bring the country out of the situation of being a laggard, turning into an industrialized country by 2020 (9th National Congress Documents - The Gioi Publishers – Hanoi 2001). However, as long as path dependent system is posited to consist of multiple stable equilibriums, an initial success has by no means guaranteed the country a qualitative step-up, nor negated the likelihood of getting stuck into low-income-level trap.

Paradox of latecomer

Once again as “history matters”, a late starting point equipped with highly-subsidized, inept state enterprises has made Vietnam’s inner forces incompatible with the outer world. Vietnam still remains a weird dualism: there are considerable strengths and troublesome flaws (Dapice, 2003). FDI firms up to now appear to be *enclaves* in the Vietnamese economy, reflecting by the tendency of importing most of materials and intermediate goods for the manufacturing process (Tran, 2004). Specifically, it is interesting to know that, according to a survey conducted by Japan External Trade Organization, while 72.9% of Japanese manufacturers intend to increase local procurement in Vietnam, 68.6% of them fail to obtain production parts and raw materials in the domestic market, compared with 40.1% in Thailand and 31.6% in Malaysia (Junichi Mori, 2005).

For whatever reason, foreign firms failed to network with host country’s production complex, impeding the possibility of integrating domestic suppliers into vertical chain. Ad-hoc co-operation between local innovation systems and the MNCs suggests that only restricted learning takes place. Many

economists believe that, along with bureaucracy, inconsistent policy and high costs of doing business, a lack of competitive supporting industry² greatly contribute to the reason why existing MNCs have hesitated to radically expand their investments; and why FDI inflows, after a sharp decline, recuperate sluggishly. Prospects for levelling up to the next ladder of development depend on not only upbeat changes to the legal and regulatory environment but also increased quality of immobile assets embracing local skills, hard and soft infrastructure, services, supply networks and so on.

For a latecomer like Vietnam, a rearward industrial foundation is not a big surprise. It is the policy maker's utmost expectation that investment in the form of FDI as a function of catalyst will arguably spur industrial development in the host country by increased employment, improved backward and forward linkages as well as technology transfer. While acknowledging that supporting industry is a precondition for attracting FDI, Vietnamese leadership assumes that only till critical mass of export-oriented FDI flows into the host country are realized and economies of scale are assured, it is tremendously difficult for supporting industry to be efficiently built. This FDI-reliant latecomer economy seems to face a paradox or a vicious circle: while the host country's *goal* is to attract a critical mass of inward investments for agglomeration and for leveraging spill-over effects to industrialize, the initial level of domestic industrial development, as a *mean*, is decisive in appealing the type and quality of FDI to rush in.

The somewhat similar situation also took place in South Korea in 1960s when American and Japanese electronics firms arrived and set up factories. As a backward country endowed with an abundance of cheap labour, Korea attracted FDI and joint ventures only as a competitive assembling place. Early foreign invested projects, driven by the target of reducing costs, generated very limited technology and know-how transfer as MNCs imported most of the inputs for manufacturing process (Bloom, M. 1991). However, catching up course happened quite swiftly, starting from simply imitations in assembly to tapping into the process of building engineering ability, to proactive initiation of local learning, and finally, the independent product innovation capabilities. By the early 1990s, three of Korean conglomerates ranked among the largest electronics makers worldwide. In other examples of the newly industrializing countries (NICs) such as Taiwan, Singapore and Hong Kong, a similar growth pattern can also be observed. The "dragons" steadily moved from passive importer-pull, cheap labour assembly to own-brand push, advanced exports into foreign markets (Michael Hobday, 1995). Success stories from NICs suggests that, for backward countries, catching up and forging ahead is promising, even though these examples have hitherto represented fairly exceptional phenomena and been far from being a concrete rule that can be transformed to other least-favoured nations. Heterogeneity of policies in assisting technological learning, ranging from the *laissez-faire*, neo-liberal approach exploited by Hong Kong government to state intervention, chaebol-led prototype adopted by South Korea, and to entrepreneurship-based, governmental-assisted model employed in Taiwan, hints that different stages of development, distinctive economic structures as well as particular institutional dogmas decides the degree of state intervention. But the few success stories can also be

instructive for potential benchmarks as some commonalities prevail: improvement through learning is a sequential, cumulative causation and export-oriented process. More importantly, learning course is supported by government's push towards a MNC-friendly business climate that assures persistent FDI inflows.

Vietnam has visibly expressed its pronounced preference for the economic growth model of "developmental stage", assuming that step-by-step industrial upgrading probably facilitate a move to an industrializing nation by 2020. The nation increasingly relies on inbound FDI to advance indigenous resources and to perk up the competitiveness of domestic industries, presupposing that the agglomeration of cost-driven MNC assemblers will, on the demand side, increase the needs for local procurement and stimulate the development of supporting industries. On the supply side, restructuring state-owned firms into diversified business conglomerates and implementing reimbursement/ punishment mechanism of localization policy are aimed to accelerate the growth of domestic upstream industries (GRIPS 2003). Considering competitive supporting industries as quasi-public goods, this push approach argued that the state must serve as conductor to orchestrate investment in needed upstream industries. State-controlled corporations with privileged access to government's supplied capital strategically act as market - substitute instruments as the country is still at the stage of a transitional economy.

Nonetheless, as we will discuss afterwards, an orderly staggered and developmental stage of industry dynamics is not easy to achieve, especially when successes in the first phase of economic growth-low skill and low value added exports-favour such a lock-in to low-road development.

On the threshold of new transition: leaping or getting locked?

We argue that the existence of an inadequate supplying base, though serious, is just a symptom rather than a rooted, direct threat to the country's new move. Institutional, functional and cognitive lock-ins that hinder learning are the main internal impediments that result into enduringly devastating, quasi-enclave situation where limited effective interaction between MNCs and local firms, between domestic and export sector as well as between state-owned and private business takes place.

Grabher (1993) analyzes why a once successful industrial region like the Ruhr in Germany eventually get locked into a dead end without persistently getting ahead. He blames functional lock-in (restrained boundary spanning capability due to densely-knitted interfirm relations that hinders interaction with outer world), cognitive lock-in (personal ties creating shared views, faiths and norms that lead to the ignorance of new opportunities and threats) and political lock-in (institutional thickness aimed to enforce regional adaptation to the existing growth pattern) as results of close intraregional interdependence for ruinous durable effects on region's openness and adaptability.

Lock-in, in this *ex post* sense, has since been increasingly exploited to institutionally clarify why region fail to proactively change the selected path of decline before such a somewhat destined downturn happens, even though a perception of superior choices might exist.

We aim to apply the concept of lock-in in a somewhat different perspective-an *ex ante* approach. Grabher's definitions of lock-ins, to our knowledge, are also promisingly applicable in questioning the sustainability of a nation's economic trajectory, especially the situation whereby an

² A terminology coined by Japanese theorists and widely used in East Asia, indicating the manufacturing sectors which produce intermediate and capital goods.

earlier “good” path-dependent development *seems* to run exhaustedly, but without a subsequent corresponding decelerating feedback mechanism (Maskell, P., et al, 1998, p.66). Therefore, it is rational and relevant to envisage Vietnam’s prospect for transforming to an industrializing country within the framework of lock-in concept, particularly as far as the country is on the course of excessively striving for perfect adaptation to the so-called “Asia’s labour-driven economic development, flying-geese style”³. Moreover, industrial restructuring in Asia as consequence of the move of labour-intensive manufacturing towards late-coming nations, which first began with Japan, later the NICs and recently China and the ASEAN-4, requires critical application and analysis of the Western concept of lock-ins in the Asian context (Hassink, R. and Shin, D-H., 2005). As Vietnam assertively joined this reallocation of industrial activity and as this shift tends to progress relentlessly due to new arrivals of even more low-cost countries, it implies that Vietnam sooner or later has to face with the problem of industrial restructuring and a scrutiny of (potential) lock-ins is therefore desperately needed.

Yet, lock-in still stays on being “fuzzy concept” (Markusen, A., 1999) as it is derived from merely regional observation and yet at stage of in-making theoretical notion. For that reason, what we illustrate here in the situation of Vietnam’s FDI-led growth pattern may not be a strict replication of what Grabher has found out in the Ruhr, but rather a somewhat idiosyncratic description contributing to the present conceptual variety⁴.

Functional lock-in

The first symptom of such a functional lock-in, which is defined here as restricted boundary scanning function for potential cooperation beyond routine business practice, seems to appear at export sector. That is, for example in the case of flagship garment industry accounts for most of the country’s job creation and export earnings, major involved participants, be they FDI, private firms or state-owned enterprises, tend to be enclave in their isolated bounded network.

Vietnamese private business operates in the export-oriented apparel industry is by and large encircled in such a captive, quasi-hierarchical governance structure⁵. In this buyer-driven network, lead firms located at the very end downward the chain dictate the guiding factors under which Vietnamese producers work. This reflects by the fact that contractual arrangement in the form of cutting-making-trimming (CMT) dominates garment exports from Vietnam as

more than 60% of clothes sold overseas are subcontracted in a manufacturing process, in which inputs, designs and specifications supplied by buyers (Dong, T. D., 2003)⁶. For the purpose of system solidity, the lead firm acts as central power to devise, direct and coordinate a common norm—that is codified specifications of end products—from which traders or first tier suppliers work out specific standards that are imposed on Vietnamese sub-suppliers. The much-curbed nature of Vietnamese producers in this case is clear as they are locked up in a set of narrowly defined, low value added tasks of assembling.

Technically, firms are unable, and to some extent unenthused, to “break” the glass ceiling of their delimited import-intensive, labour-abundant territory. According to Gereffi, G. et al. (2005), such a captive value chain is pronouncedly preferred when the complexity of products and requirements are both high whereas supplier competences are somewhat low and a hierarchy-like governance promises reliability of delivery plus quality control. In such a low-tech export industry like garment where the technology gap between MNC (affiliates) and local firms is allegedly narrow, the fact that CMT practices still dominate which leads to a consequent limitation of inputs sourced locally should be noted. This relates to possible restricted learning by export as low-cost labour contractors are regarded inept in independently fabricating internationally competitive merchandise; and/or domestic upstream textiles, exclusive of incompetent capabilities, are not striving hard enough for linkages beyond traditional domestic business arrangements.⁷

Textile industry, which provides intermediate goods such as yarns and fabrics for garment manufacturing, is considered to be capital-intensive and import-competing. This explains why state-owned enterprises with privileged access to capital and FDI firms—with the former predominating—are actively involved in sub-sectors of spinning, weaving and knitting, making up more than 80 percent of current 227 projects (Dong, T. D., 2003). Vertically integrated state-run companies, in some measure, contribute to local procurements as they utilize about one third of textile outputs for their garment exports (Thoburn, J. et al, 2003). A limited number of apparel joint ventures attempts to obtain intermediate goods domestically because the Vietnamese partners possess subsidiaries operate in the upstream stages. In the case of wholly-owned foreign firms, the operations of garment manufacturing either exclusively rest at imported materials or strictly confine to supply of other textile FDI companies. In the extreme case as for a Japanese fully-owned clothing maker, a period of 7 years continuous running witnessed such a very stagnant process of domestic sourcing, as by 2003 the local content of major inputs (yarns) just reached a modest figure of 3 percent (Tran, 2004).

The export enclave character of apparel manufacturing is not just an industry-specific phenomenon but can also be observed at structural level. A look at the broad picture of Vietnam’s FDI-led industrialization suggests that, main exports have generated little, if at all, vertical inter-firm

³ Ozawa’s phrase to describe Asia’ region-wide mechanism that allows backward nations to joint the process of growth catch-up as they strategically and comparatively position themselves as vital sources of unskilled, cheap labour. In Ozawa, 2005.

⁴ Markusen (1999) posits that fuzzy conceptualization appears when one particular notion possesses two or more alternative meanings, causing confusion and ambiguity in operationalisation. Hassink, R. and Shin, D-H. (2005) agrees that lock-in bears the risk of being vagueness, as it is, based on limited regional scrutiny, inductively and bottom-up built. Nevertheless, we share with Grabher and Hassink, R. (2003) that while arithmomorphism tends to blind us to the ‘grey area’ inherent in the process of evolution and change, fuzziness allows abstract polyphony that mirrors reflexivity, creativity and variety. Hence, despite potential weakness of the concept, a purposive exploitation of lock-in in explaining the development trajectory of Vietnam is quite sensible and pertinent.

⁵ Humphrey and Schmitz (2000) define quasi-hierarchy as chain governance where buyers have a high degree of control over suppliers.

⁶ In Goto (2002), the proportion of CMT contract value in total export earning is estimated as high as 90 %.

⁷ We are however not ruling out the fact that Multi Fibre Arrangement granted Vietnamese enterprises “quota-rent” competitiveness to join apparel-producing network, and yet defined their captive role as subcontractors of quota-sensitive items. For more details on this issue, please see Khalid Nadvi and John Thoburn (2004).

linkages with the rest of the domestic economy. Technology spill-over allegedly generated by backward linkages is therefore constrained.

Market-seeking FDI dominates the list of total implemented foreign investment as the top 4 industries (non-ferrous metals, food and drinks, car and motor-cycles, plus chemicals) comprise about 53% by 2002 (Tran, 2004). Since foreign firms are searching for unsaturated overseas market with soon-to-be growth to obtain proximity to demand, highly protected domestic markets attract a number of capital-intensive FDI projects. These tariff-jumping firms, which tend to resemble high-cost state enterprises in many ways (Dapice, O. David, 2003), employ a small number of employments, and *imperfectly* substitute trades.

In export-driven sector, resource-seeking and efficiency-seeking FDI take place as foreign companies hinge on host country's inexpensive supply of labour for the purpose of redistribution and rationalization of their value chain. The most successful export FDI locate in industrial parks and export processing zones. FDI-led, labour-intensive manufacturing has effectively integrated into global production network but is devoid of a robust connection with local supplying base. Insofar as backward linkages "are associated with frequent information flows, which allow for quality improvements, reduced delivery times, and fast upgrading of designs in response to changing demand conditions for final products"⁸, the formation of export processing zone and high-tech enclaves does not necessarily imply an automatic process of knowledge spillover, since MNCs are in fact not "leaky container" of expertise and their appearance alone can not guarantee, excluding intra-firm transfer, horizontal inter-firm learning by imitation (Ciravegna and Giuliani, 2005).

As a result, there exists a dualism characterised by the missing link between tariff-protected domestic sector and globally competitive, FDI-led, export area (Kenichi Ohno, 2004). This phenomenon of industrial divide has also been witnessed elsewhere, for instance in other countries of South East Asian, where previous efforts to prop up trade-substitute industries are often followed by promotion of disconnected export processing zones and licensed manufacturing warehouse (Jomo, K. S. et al, 1997). In Thailand, foreign-dominated, technologically-rich export operates in parallel with, but is mainly isolated from, the domestic, technology-poor, import-competing sector (Doner, 1999). Lall et al (2004) observe a similar case in Latin America where the few exceptional triumphant manufactured exports face the threats of being eroded as export activity is often delinked from local industry and capabilities.

Yet, Vietnam remains a fairly idiosyncratic tale with respect to the fact that in this transitional economy, where *late industrialization* goes along with *in-progress marketization*, the appalling duality takes place not only in import-substituted/export oriented dichotomy, but also extends to a "weird dualism" of state owned/private business.

In the path to a market-based economy, Vietnam employs a gradualist approach as the promotion of non-state-owned sector escorts a premeditatedly delayed removal of the hegemony by which state-endorsed enterprises are presently benefiting. On the one hand, reforms of state-owned enterprise have visibly been implemented as management autonomy is granted upon condition that more hard-budget constraints and

sophisticated external monitoring mechanism are imposed. On the other hand, state sector's inefficiency yet lingers. Despite the fact that this sector occupied a huge, rising share of investments and enjoyed substantially preferential treatments in terms of land rights, resources, infrastructures...etc, thus far it has contributed modestly to job creation as well as industrial outputs, especially when compared with much less favoured non-state area.

Many economists, by general consent, voice that state enterprises have in fact made great loss if their reported profits are exclusive of "soft" and "hard" subsidizations. It is necessary to quote Dapice's criticism on this situation at length: "[T]he state enterprises often have a very high degree of protection yet need to borrow large amounts to maintain their growth. Most unregulated monopolists do not need high levels of borrowing because they have super-profits. Over half of SOE investment is funded by credits from state sources, including but not only bank credits. When a country puts most of its investment funds and almost no labour into a sector that cannot generate its own cash flow or maintain its share of output, even with protection and other advantages, it is not a sign of good economic management...The non-state sectors could create more and more stable jobs and get more output per dong of investment. If they had a larger role, there would be more exports, less debt and higher profits without protection" (Dapice, O. David, 2003).

Overall, lock-in at both sectoral and structural level denies such a boundary-spanning function for potential cooperation and interaction beyond existing conventional practice to emerge. It is true, at least when we boil down to the illustrative case of apparel industry, that the key involved players, no matter who, be they state-orchestrated enterprise, private business, export-oriented FDI or import-competing FDI, each tends to manoeuvre in its circumscribed, over-embedded and routine orbit without either *ability* or *willingness* or both to interpenetrate into outer environments. Non-existence of robust economic incentive and over-embeddedness within each individual's network prevent such a necessarily overlapping, interwoven and nested interaction of all juxtaposed actors from occurring. In other words, institutional segregation of cohesive subsystems (that is state, private and international firms) appears. This so-called isolation of fragmentary cohesion is as well underpinned by the actors' cognitive preference for status quo bias. We therefore posit that enclave industrialization is not something of nature that immutably appears at the very first phase of catch-up process where technology gap is assumed to be wide. Even in low-tech sector, footloose exports are still observed as cognitive inertia is a factor of great importance that refutes motivation to move beyond in-network search.

Cognitive lock-in

Captive value chain, as Gereffi et al. (2005) rightly puts it, has great propensity towards situation where small suppliers are increasingly locked in transactional-dependent pattern due to asymmetry in power, capabilities and market information. Nevertheless, in a labour-surplus, transitional economy like Vietnam where private enterprise is yet at its infancy and naturally undersized in both capacity and competence, it seems that integration into a quasi-hierarchical chain is normally the most preferred option. Sacrifice of supplier autonomy is compensated to the extent that strong specific supplier-buyer relations provoke possible exploitation of production interdependencies. In some measure, what small contractors may benefit is numerous, ranging from relatively guaranteed market, clearly-defined price arrangement,

⁸ Belderbos et al. (2001), p. 190.

predictable production and delivery schedule to a release of burdened coordination tasks if functioning alone. These perceived advantages were realized in Vietnamese furniture industry when IKEA—a Swedish low-priced home furnishing retail chain—entered the country in 1994. Being an authoritative global buyer with connection to about 1500 suppliers worldwide, IKEA soon shocked the host country's wooden processing and manufacturing sector with huge contractual orders. It is considered as the usual IKEA way in luring potential contractors to join the company's supplying network. With respect to the corporation's gigantically appealing size, one regional quality manager puts it this way: "When we place an order, we are not talking about 250 pieces only – we are talking about 25 to 50 containers. This factor alone has the effect that a supplier almost turns his factory upside down just to deliver to us."⁹ This makes clear why local firms are keen on joining the system of making-to-specification. One entrepreneur that owns a household wooden manufacturing factory discloses: "We are so much happy that, after years looking for export markets, we are finally successful in signing a contract with IKEA. Partnering with IKEA is more than wonderful since we just have to focus on production rather than to be involved with so many duties such as designs, packing, logistics, distribution and brand management...as we used to when dealing with domestic market...Our annual export turn-over aggressively grows and reaches a peak of 1.6 million dollars...Integration into supplier-buyer network definitely allows us to concentrate on our specialization and enhance capacity."¹⁰

The fact that insertion into confine-like supplying network facilitates producers from developing countries to move to swift product and process upgrading is empirically proven; the most evident illustrations are the Sinos Valley—a highly specialised southern Brazilian cluster that produces footwear (Bazan, L. and Navas-Aleman, L., 2004) and the South African wooden value chain (Kaplinsky, R. et al, 2003). The possibility of fast upgrading in captive value chain, according to Schmitz, H. (2003), is prompted by the dual role of the buyers: they not only impose rigidly demanding codified specifications over supplier's manufacturing process but also offer comprehensive support as well as stringently supervision in a way that ultimate system solidity is assured. In this way, suppliers will be guided to learn to improve.

So far, external conditions and internal constraints have tempted firms to willingly stay in a cosy reliance cooperation with their key authoritative buyers¹¹. Further, there is a so-called "group think" which is prevailing among export-oriented sector that contributes to the consolidation of existing captive value chain. That is, firms have increasingly expressed their prejudiced preference for export. Increases in export turnover are explicitly considered as clear indicators of success and internationalization. While there appears to be nothing wrong, at least theoretically, with this common orientation, the negative consequences of the shared bias view are, in fact, twofold.

First, a favourable attitude toward exporting leads to resultant compromises with dependency.

Second, bias towards selling abroad brings about the risk of ignoring domestic market. According to Nadvi, K., (2004),

export-striven garment manufacturing sector has in effect overlooked to trade domestically and left most of this market, whose value is estimated at 1 billion dollars, to Chinese clothing makers (Thang, P. V., 2005).

This fact raises attentive implications. Study on the victory of industrial upgrading in Sinos Valley shows that involvements in (captive) global value chain should always go along with deep penetrations into national chain (Bazan, L. and Navas-Aleman, L., 2004). While supplier network promises a fast track to product and process upgrading, it is the unsaturated domestic market where manufacturers can experimentalise their own designs, distribution, brands and customer relation management. A short term risk-reduced shield from direct interaction with marketplace inevitably leads to a lasting lag in functional upgrading which is by all means the goal manufacturers ultimately have to head for. Rigidity specialization, not only in a limited number of customers but also in form of restricted manufacturing tasks, can erode supplier's survival so long as they operate detachedly with exigencies of end patrons. However, the role of national chain as room for experimentation of functional upgrading is of minor magnitude if transactions outweigh interactions. In this perspective, Schmitz, H. (2003) notes that "transaction is about buying and selling; interaction is about exchanging information and experiences on what to make, how to make it, and how to increase speed and flexibility".

In addition, even as it is immature to deem that Vietnamese small suppliers in low-tech industry are intrinsically reliant, a pronounced partiality towards business expansion instead of business deepening brings about "passive pliability" as opposed to "active versatility" (Semlinger, 1992). While the latter is theoretically associated with small enterprise in a sense that boundary-spanning is fully integrated into decision-making process that helps form a high capacity to react and adapt, the former, which is often encountered in real-life business, supports subordinated flexibility which is typified by the aptitude for compromising with outside pressure. In case of captive chain, small suppliers, by exploiting their distinctively defensive elasticity, seek an adaptation to lead buyer's squeeze of price structures. Small producers in facing with the pervasive process of marginalisation brought forth by amplification of even lower cost-based competitors in world supplies are "racing to the bottom" in order to maintain their competitive advantages. Flexibility in this sense is characterised by the cost-cutting art of survival since burden of decreasing returns are shifted to cheap handicapped workforce. In a study of industrial restructuring in Korean's clothing industry, Kang Huyn-Soo (1997) observes two patterns of reformations in dealing with the decline: high-level, high price products based on flexible specialization and unchangedly advantage of cheap labours through outsourcing informal sectors. Prior rigorous embeddedness in low-value added, mass produced manufacturing has effectively propelled apparel makers toward the latter approach as they deliberately search for variability of their employment capacity. Facing with price pressure and the advent of mass customization, most manufacturers have, instead of switching to high road option due to technical and cognitive constraints, vigorously defended their position by sub-contraction to temporary and home workers who are easier to be pressed to accept unstable job security, poor condition of work and low wages. Passive pliability, in this way, is obviously a concealed part of SME's appeal to purchaser (Semlinger, 1992); nevertheless it hardly constitutes sustainable competitive advantages.

⁹ Pedersen R. E. and Andersen M., (2005)

¹⁰ Nhu Hang (2005)

¹¹ In case of Vietnamese supplier/IKEA buyer, 30 percent out of existing 47 contractors rest exclusively on IKEA as their sole customer. Source: Nhu Hang (2005)

Hakansson and Johanson (1993) once note that network delimitation is something very arbitrary and subject to cognitive model. In other words, network technically supports expansion. Limitation of network, if exists, depends on agent's view of network boundary which again varies from one to one as result of individual angles, objectives and interpretations. This comment is actually meaningful when one takes into account that it is cognitive flexibility that breeds the dynamics of business relationship. The more diverse the cognitive structures of SMEs are, the higher possibility of moving beyond "local search" and arrange business cooperation into new directions, which may include new actors that would have never been thought of due to restricted boundary spanning. The above emphasis on cognitive lock-in as interior obstacle to small firm's move beyond locked-up relationship with big business has absolutely not been relevant in case of "sweatshop" SMEs, who located at the very end of the spectrum, deliberately confine themselves to the highly flexible capacity which can be arbitrarily expanded or shrunk (Semlinger K. 1993).

Similarly, it is important to bear in mind that the behaviour of MNCs also decides the type and quality of cooperation with local producers. When MNCs first set up affiliates in a host country, they have great tendency to follow-sourcing the most important inputs as their existing voice-based supplier relations promise an avoidance of random lapses in efficiency¹². Such a voice-based affiliation requires a great deal of mutual trust as precondition for lasting collaboration. Hence, priority should be assigned to long-term home contractors rather than riskily looking for new alternative providers. A superficial gaze at Vietnamese automobile industry supports this. Keiretsu-like supplier relations govern the overall sourcing process of inputs among car-producing firms. Localization and performance requirement policy aimed to create forced linkages between foreign manufacturers and local suppliers actually failed partly because of the gap in technology, partly due to cognitive barrier as communal trust is a long way from being established. A common view among foreign investors is something like "Why do we mind sourcing locally bearing search costs and uncertainty, while we already possessed reliable partners".

The same thing happens in technology-stable, captive value chain. Global buyers fix on not only designs, specifications but also source of inputs. What they expect from low cost, developing countries is exit-based competition in assembling activities where acceptance of low margins and abundance of wage-squeezed labour force are the key things that matter. The steadiness character of manufacturing process requires a low degree of commitment and technological change. Hence, it leads to the fact that knowledge exchanges are confined to information stream of codified expertises, most of which focus on fabrication guiding. This channel of know-how transfer is often one-directional flow from MNCs to local producers. Profound and balanced cooperation then can not be achieved until bidirectional, or more exactly, interactive communication between suppliers and buyers are realized.

This is to say there are particular situations where local producers may have already acquired relatively competent

know-how, deep cooperation does still not occur since MNCs have already been cognitively locked into a voice-based network.

Institutional lock-in

Amplified interdependence within East Asian, apparently the enhanced reallocation of employment that shift the most labour-intensive, least innovation-based stages of production process from the developed and newly industrializing countries to latecomers, is arguably considered as the main driving force behind South East Asian nation's flourishing export-oriented industrialization. The flying geese paradigm is still ostensibly dominant in the realm of Asian economic development, emphasizing the role of FDI and MNC-led growth (Akamatsu, K., 1961; Kojima, K., 2000) even though its original sense of Japan as single economic and technological source for regional integration has come to an end (Ozawa, 2003). Direct-interdependences in industrial upgrading and restructuring in East Asia can be judged as a process of *orderly* staggered relaying of value chain as value fragmentation keeps high-value added in top tier countries and drive low-value added down to lagging nations. In this standpoint, Ozawa (2005) highlights: "The faster the pace of Japan's catch-up growth by climbing up the ladder of industrial upgrading, the greater the pressure on—and the easier for—Japanese producers to transplant disadvantaged (low value-added) industrial activities to low-cost locations in Japan's nearby countries so that they would be able to maintain and, in fact, enhance competitiveness in the world market" (Ozawa 2005, p.21).

Impressed by what Japan, the NICs, ASEAN-4 (Thailand, Malaysia, Indonesia, and the Philippines) and recently China achieved by pursuing the successive allocation of labour in export-oriented growth strategy, it appears to be natural why Vietnam is content with its lot being a paddling fowl in the flying geese model of East Asian growth. An economic policy orthodoxy that necessitates more open business environment, low-wage driven exports and a *pushed* enhancement of local supplying base appears to exist in Vietnam. In this recipe of development, FDI attraction increasingly moves from a core ingredient to a final required taste.

However, the orthodox policy set discloses itself as fundamental problem. If we take it for granted that Vietnam will eventually be successful in creating a transparent, red-tape free and legal-articulated business climate, offering various generous tax incentives as well as establish more export-oriented industrial parks—all the things that most of first-tier nations of ASEAN have already done, does it effectively position the country as the attractive destination for FDI inflows? And, more importantly, supposedly a critical mass of inbound FDI is to be reached in current direction that enhances over-dependence on cheap labour competitive advantage as well as nurtures tariff-rent domestic manufacturing, does it lead to a *qualitative* industrial upgrading, or enclave and footloose industrialization continues to be self-reinforcing and incompetent import-substitute sectors collapse under free trade. Since successes gained from the contemporary economic development course are impressive but unsound; we are uncertain that desperate reinforcement and expansion of existing policy will bring any significant outcomes.

Vietnam automobile industry is a lucidly symbolic example of how influential institutional coalition obstructed opportune adjustments of inefficient infant industry protection and paralysed policy changes. Consist of nine automakers and two licensed assemblers, Vietnam automobile industry is a

¹² Hirschman (1970) postulates two types of responses to decline in firms: exit as clearcut either-or decision of switching to a superior substitute and voice requires ongoing joint communication and cooperation to change, rather than escape from, an objectionable state of affairs.

result of joint venture cooperation between state-owned business and foreign investors. This capital-intensive, trade-substituted industry employs as much as 5000 workers and accounts for approximately 500 million dollars investment. Being the most tariff protected sector with taxes rate up to 300 percent, car-building industry in Vietnam has however failed to speed up the process of efficient local manufacturing. This reflects by the modest localization ratio as well as very high prices of locally assembled vehicles. So many factors are blamed for the poor performance such as low capacity utilization, non-existence of a competitive supporting industry and restrained market demand. However, the fact that auto-maker firms operate at just 30% of designed capacity does not trouble the country's 11 automotive joint ventures much in enjoying reported profit of 10.8-24% each year. Policy makers are sceptical about car producer's long term commitment and losing patience. One senior economic adviser comments: "We call it a young industry, but in fact it has had 10 years to develop. If they can't rise to the occasion and can't exist in competition, let them go. The interests of consumers must be put above all. It is irrational if we let consumers' pockets be picked". Some even go further by asking whether it is rational and necessary for Vietnam to build automotive industry given the fact that more than a decade sacrifice of consumer welfare only tolerates foreign investors to exploit tariff-rents. Vietnam's recent agreements on used car imports are widely considered as, in addition to free trade pledges, part of policy innovations that forces car auto manufacturers to reorganise production and reduce auto prices.

Nevertheless, this decision was severely opposed by manufacturers and eventually government had to offer a compromise: import of used autos is still allowed, but with an exorbitant import duty structures. It is argued that the emergence of interest groups-the influential Vietnam automotive manufacturing association-creates the so-called "institutional sclerosis" in car-making industry. Rent-seeking lobbies have impeded strategy alteration to crop up even when the need of policy change is already perceived. Still, the author deem that the other imperative reason that obliges policy makers to continue upholding unproductive protection is the institutional sunk cost they face if the fragile auto-making sector crumples. That political dedication and forfeiture of national's wellbeing are irrevocably committed to the establishment of the industry consequently denies any intention of exit. Since prior mistaken endorsement smoothes propensity towards the voice option, continued attempts to shield the sector, though desperate, will at least cognitively solace decision makers.

At the macro level, institutional lock-in, in a sense of thorough adaptation to FDI-led industrialization but without critical promotion of endogenous learning attitude, has been resulted from the confusion between means-increase in FDI and exports and ends-development sustainability. As Gallagher, Kevin P., and Lyuba Zarsky (2004) put it when explaining why Mexico failed to build a sustainable industry: "As a starting point, the government should embrace *sustainable industrial development* as the centerpiece of its development strategy. This would mean, first of all, that the fundamental goal would be not to increase FDI *per se* but to improve the overall climate for domestic production and investment, most importantly including investment by domestic investors in domestic firms".

III. Concluding remarks

As analyzed above, there are reasons to believe that, the ongoing FDI-driven, economic restructuring and industrialization process in Vietnam has warning signs to become a path-dependent trajectory of decline. Initial resounding successes have prompted system-wide positive feedbacks that, in turn, overshadow the outlook for the nation's probable ending up in the trap of low road development with its industry staying in a perpetual state of backwardness.

Moreover, the ability of the country to change the nature and course of its economic pathway-that is, path-breaking, does not hinge only on its ability to perceive the unceasingly ineffectual outcomes resulted from the present adopted strategy. Exorbitant switching costs can prevent such an act of changing path despite awareness of superior alternative

While it is extremely thorny for involved agents to individually escape or break the existing path, purposely collective attempts to create new path is possible especially when this in-progress course has not yet acquired enough crucial possessions of a path, in terms of both quantity and quality. Past growth pattern perceptibly signifies shapes of current and future development courses as positive feedback loops from precedent unbeaten decisions are self-reinforcing. Nonetheless, if expected effects engendered by (potential) superior path actually outweigh pricey switching costs, and if "a process logic of mindful deviation" effectively challenges "a variance logic of consequentiality" (to use Garud & Karnøe's phrases, 2001), such a change of path is achievable. Certainly, any local-oriented endogenous growth effort alone cannot yield radical outcome unless there is a strategic exploitation of external favouring forces.

In this perspective, we can argue that if path dependent trajectory of decline, where ubiquity eats up specificity, can trap a country into the downward corkscrew of cost-based competition, it is also cumulative and path-dependent dynamics of knowledge accrual that assures sustainable patterns of a country's specialization as long as localised learning process is triggered and sustained (Peter Maskell et al, 1998). Insofar as agglomeration and path dependency go hand in hand in dictating the concentration and degree of technological learning and innovation (Lall, 2003), an uncalculated move to industries where expertise gap is enormous will breed wasteful investment irrespective of how deep state intervention is. The lessons from low-to medium-technology specialized Nordic countries have already shown that providing an attitude of constantly learning and producing knowledge based on existing capabilities is maintained, nations which are not destined to be foremost high-tech powerhouses can still walk a high productivity pathway.

When positing so, we by no means seek to deny the country's premeditated reliance on FDI as well as its cheap labour-based embeddedness in global value chain given the sheer size of unskilled workforce. Rather, what we want to highlight and find it worth emphasizing from this rudimentary scrutiny are the two findings.

First, external dynamics do not favour Vietnam a concretely staggered, highly sequential developmental stage of catch-up; that is, succession of import, import-substitution and export orientation. On the one hand, immediate requirement of international integration does not allow a long protection of infant industries. On the other hand, extravagant tariff-rents only empower interest groups to sclerotize institutions in order

to preserve the established harmful situation as in the story of car-building industry.

Second, sustainable prosperity can only be realized if policy makers maintain such a constant vigilance of the double-edged characteristics of cheap labour advantage. Localised learning should be promoted as tacit weapons that helps firms, even small suppliers in low-tech sectors, to survive in such a period of global economic turmoil.

Seeing that “wages squeeze” still allows the country to enjoy (temporary) static low cost advantage, the paper’s ex ante scrutiny of (potential) lock-in might hence be considered as a contribution that is yet in its infancy. In addition, since illustrative cases are restrictively applied to only some industries as sectoral background of analysis, we admit that our writing bears the risk of drawing an over-simplified picture of the interaction pattern between multinational investment and local production complex. This leads to the need of carrying out empirical studies on existing inter-sectoral value chains to investigate the robustness of arguments raised here and to avoid foregone conclusions.

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