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DANANG: POLICY OPTIONS FOR INVESTMENT AND ECONOMIC DEVELOPMENT

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EXECUTIVE SUMMARY

Danang is the "center of the center" or the major city in the central region of Vietnam. With a population of only 730,000 and relatively small effective hinterland, it is at something of a disadvantage relative to the two major cities of Vietnam. Its domestic market is fairly small and there are not international schools, a large foreign community or concentrations of sophisticated financial services or marketing and consulting that Hanoi and HCMC are developing. But with a good harbor, ample skilled and semi-skilled labor, and international airport and highway connections, Danang has many potential advantages. Still, by 1997 when it was split off from Quang Nam and able to focus on its own development, Danang was well behind the other two cities. Its output per person was then only 5.7 million dong compared to over 9 million for Hanoi and over 14 million for HCMC. This reflected a low value-added industrial sector with few linkages, as well as an unsophisticated service sector.

From 1997 to 2000, the Danang government decided that it needed to upgrade its physical infrastructure in order to approach the other two major cities as an attractive location for investment. Infrastructure investments rose from VND 99 billion in 1997 to VND 600 billion in 2000. A new bridge was built across the Han River, the airport and seaport were upgraded, and preparations were made for other improvements. These will include the Hai Van tunnel, the East-West Corridor and the Tien Sa Port. All of these should be completed in the next two to three years. In addition, and after some delays, there were three new industrial parks built covering 861 hectares.

Danang: Investment by Source (Average per year for two-year periods-Billion Dong)

	1997-98	1999-2000	2001-2002
Government Budget	202 (18%)	650 (53%)	475 (24.9%)
Directed Loans	145 (13%)	170 (13.8%)	349 (13.3%)
State Owned Enterprises	127 (11.5%)	135 (11.3%)	330 (17.3%)
Sub-total: Public	*474 (42.5%)*	*955 (78.1%)*	*1154 (60.6%)*
ODA	30 (2.6%)	47 (4.0%)	111 (5.8%)
Foreign Direct Investment	432 (38.4%)	78 (6.3%)	215 (11.3%)
Private-Individuals	123 (11%)	102 (8.4%)	191 (10.0%)
Private-Enterprises/Mixed	61 (5.4%)	40 (3.2%)	234 (12.3%)
Total (Billion Dong)	1120	1224	1905
Total (Million $)	$85.7	$85.3	$122.9

Several things are interesting from the table. First, ***total*** investment did not change very much when measured in US$ – a pretty good measure in real terms - over the 1997-2000 period, but increased significantly in 2001-2002. The composition of investment shows a more interesting pattern, with the expected bulge in government budget in 1999-2000 to over 50% of the total. FDI had been a major contributor, but then slid, and its share recovered only partially in 2001. Individual private investment fell relatively throughout. State enterprises and directed loans together moved from a quarter to a third of the total. Public investment of all types remains well over 50% in 2001-2002, in spite of a strong jump in formal domestic private investment. What can one make of all of this?

Danang is a work in progress. The "hard" infrastructure investment has created a potential for investors, and some of this is seen in the almost nine-fold jump in DPI (domestic formal private investment) from 1999-2000 to 2001-2002. There are some indications that both DPI and FDI rose again in 2002. However, these are only indications of a possible success. To be completely successful, we should observe a steady growth in real investment. This will have to pick up considerably to fully justify the large infrastructure outlays. *By 2000, per capita income relative to HCMC and Hanoi had fallen slightly compared to 1997*. One would hope to see stability or even gains.

To put the issue another way, consider the flows of population. According to 1999 Census data, 6% of the population living in Danang in 1994 were living outside of the city in 1999. Population growth of just over 2% a year is above the national average, but scarcely indicative of rapid growth in job opportunities. For a city with good human and physical capital, why is there not more activity and population growth?1

The leadership in Danang has asked this question, especially for FDI. They first realized that Danang lacked strong companies to supply and partner with foreign ones. Human resources needed improvements in certain skills and sea freight charges needed to be lower. It then moved on to make the "soft" infrastructure better with "one-stop shopping" for investors and easy terms in the industrial parks with low taxes. The results have been positive with registered FDI rising from only $14 million in 2001 to $52 million in 2002 and $31 million in the first quarter of 2003. (This ignores rescinded projects, which were larger than new ones in 2000 and 2001.) Above all, they are said to be trying to cultivate a relationship in which problems can be solved quickly. These steps, as they become effective, should show results in implementation as well as approvals though it will be some time before the realized FDI investment levels of 1997-98 are surpassed.

The key to improving Danang further will lie in producing stronger domestic private companies to partner with foreign ones. The jump in DPI in 2001 to $63 per capita from only $7 per capita in 2000 certainly suggests that some changes are occurring. (The $63 per capita level is nearly three times the national average and the fourth highest province in all of Vietnam.) Yet to sustain this and make it a source of

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[1] For comparison, the population of both Hanoi and Ho Chi Minh City grew over 3% a year from 1999 to 2001. This is also true of Binh Duong and even Binh Phuoc, a poor province with little FDI or state investment.

continuing growth, further changes are needed. The financial system is still weighted heavily towards state enterprises and lending to the government. Notice that the phrase is "financial system" and not simply "banks. " The Development Assistance Fund is a major source of loans for projects and though in principle it can lend to the private sector, it usually lends to state enterprises and for infrastructure. Even within the commercial banks, the share of the private sector in total loans is dropping. (See table below.) While the private share in 2001 is higher than in 1999, it is still very small and much lower than 1997. State enterprises increased their share of bank loans to nearly four-fifths in 2001. If the Development Assistance Fund is added in, the results are even more one-sided. State firms similarly increased their share of ownership from 51% in 1997 to 58% in 2001. The share of privately owned output fell from 41% to 34% in the same years. (FDI at 7-8% covered the rest.) These trends do not suggest a healthy environment for private firms. Without access to credit and favorable regulation, they will have trouble competing.

Share of Bank Loans and Output: State and Private Sectors in Danang

	1997	1999	2001
Private credit	32.6%	15.7%	21.5%
State Enterprise Credit	67.4%	84.3%	78.5%
Private Output	41.3%		33.8%
State Enterprise Output	51.0%		58.0%

So, Danang is doing better than average but overall is still heavily weighted (at least through 2001) towards the state sector. Its economic and population growth have been slower than other major urban areas. It has rightly identified some of the barriers to FDI over which it has some control, such as physical infrastructure, skills training and regulation. But, perhaps because of lingering attitudes that are suspicious of private domestic activity, it has been slow to provide supportive conditions for local private investors. In spite of this, private investors have used their own money to set up businesses – and at a far higher rate than most other provinces, at least in 2001. But as Vice Chairman Hoang Tuan Anh said, Danang needs strong companies to be partners for foreign investors. While private firms will start without much help, they will not grow strong without access to the same resources as their competition in other parts of Vietnam and China. This will mean access to land and credit, not simply permission to operate.

What of the future? One line of thinking is that strong companies can be – or *should* be state enterprises. The Master Plan of Danang calls for **major state investment in industries** such as textiles, seafood processing, engineering, electronics, construction materials, and shipbuilding. If state enterprises can generate their own cash from profits, this would be fine. If the plan is to rely on large state credits, then it might be both more difficult and more costly. It will be more difficult because poorer provinces will have an increasingly stronger claim on state resources. After good infrastructure is built, the richer provinces should be able to attract industrial capital themselves. It would be more costly because experience has shown that many state enterprises are set up without objective investment appraisals and end up being high cost and having trouble competing. But a large part of the expected industrial growth is projected to come from state enterprises. It is unlikely that unprotected (low-tariff) production will attract foreign investors to partner with state enterprises. So this Master Plan will undercut attempts to raise FDI by creating firms that rely on state support rather than competitive prowess.

An alternative is to create a generally favorable investment climate for business, **treating state and private businesses equally**. (This is difficult to imagine, but that would be the trend if not the reality.) By implementing further reforms and building on the success of the Enterprise Law, Danang could foster the strengthening of any competitive local firm. It would do this not be directing credit, especially cheap credit, but by allowing banks to make loans to those who are likely to repay. (Banks themselves need to improve their skills in loan assessment.) It can make land equally available. It could help business associations operate so they would do the marketing and technical studies that individual small and medium firms find difficult to do individually. This strategy would result in a much larger private sector and more firms able to partner with foreign ones. This appears to be the direction that China is taking, as its private industrial share increases.

One way to implement this alternative strategy is to begin ranking provinces on their business friendliness, just as many nations now are. By interviewing business leaders confidentially, it should be possible to gather information on specific issues such as difficulty in getting land, loans, negotiating taxes, etc. This would help Danang see how it ranks relative to other provinces and suggest areas to focus efforts.

A third possibility is to focus on becoming a service center. Let Quang Nam, just a few kilometers away, offer cheap land and labor for manufacturing. Like HCMC, which has let its surrounding provinces take on much of the manufacturing, concentrate on lowering costs and improving service in finance, transport, trade, marketing, and other activities needed for production businesses. Already, more than two-thirds of the investments under the Enterprise Law are trading businesses. If a regional approach is taken, the volume of exports will allow more frequent port calls by ships and improve the cost and frequency of transport. [When every coastal province wants a major port, no province gets one!] In addition, there are amenities that eventually could be added to attract foreign residents such as better hospitals, international schools, and upscale housing. However, these are not immediately feasible, so it is probably more realistic to expect small-scale FDI projects in the next several years. These often involve nearby Asian investors less sensitive to these amenities.

In summary, Danang has made a good start by building hard infrastructure and beginning to address "soft" [regulatory and administrative] infrastructure for foreign investors. It needs to continue along this line, finding ways to expand fair opportunities for domestic private investors so they are more nearly treated equally with the currently favored state sector. If Danang can do this, with its history of conservative attitudes towards the private sector, then many other places in Vietnam can do it too.

Of course, more is needed on a national level. However, if provinces learn not to "call" for investments in which they specify the output, scale, and partners for the foreign investor but instead work to attract investors by lowering costs, much can be achieved. If they learn to think of domestic investors as being more important in most cases than foreign investors, at least in the aggregate, they will begin to do more sensible things that some provinces have already done. In short, provincial level management is the key to growth. The Center can open the door, but the province has to make sure there is no barrier to the door and that the path is smooth. It is the individual firm that actually walks through the door.

DANANG: POLICY OPTIONS FOR INVESTMENT AND ECONOMIC DEVELOPMENT

Background

With a population of 730,000 people, Danang is the fourth largest city in Vietnam, and the largest urban center in the Central region. Situated on the national transport axis with major road, railroad, sea and air transportation links, the city has a favorable geographical location and serves as the gateway to the Central Highlands.

Danang is also one of the country's leading areas in social development indices. The Vietnam human development report in 2002 showed Danang as second only to Hanoi and Ho Chi Minh City (HCMC) in terms of human development indices. The city has two universities (of which, Danang University is a large scale polytechnic university), two colleges and seven vocational schools. These are supply sources of skilled and semi-skilled labor for the city's economic sectors.

However, since the introduction of the economic reform policy (do moi) in the late 80s and early 90s, Danang has not been able to translate its advantages into additional economic growth percentage points. Many reasons have been put forward for this.

First, compared to HCMC and Hanoi, the marketplace in Danang and neighboring areas suffer from low purchasing power due to the low level of income of the population. Danang's industrial sector mainly consists of simple processing industries with low value added, and typically lacks forward and backward linkages. Complementary products and processing work for the engineering, textile, garment, and seafood processing industries have to be brought in from other localities at high cost. Low-productivity commercial activities account for a large share of its service sector. Very much like other cities in Vietnam, however, Danang's state-owned sector accounts for 45% of its GDP, with many inefficient state-owned enterprises (SOEs). These SOEs act as a drain on resources and create an obstacle to the city's growth. In short, Danang does not have a number of the critical advantages which HCMC has, while at the same time it bears the burdens of an urban center which rural provinces such as Binh Duong are free from.

Second, until 1997 Danang's status had been one of the 16 administrative units under Quang Nam-Danang province. That is to say, unlike other cities under the central government such as Hanoi, HCMC and Hai Phong, Danang was a city under a provincial government. This meant the city had almost no budgetary autonomy. Of the total budget revenues of the province (approximately 1,100-1,200 billion VND/year), only 45% (or 400-500 billion VND) was re-allocated to the province and this was then distributed among all 16 administrative units. Danang's own budget in particular, and Quang Nam-Danang province's in general was only just enough for current expenditures.

The year 1997 marked an important turning point in the socio-economic development of Danang when the city was separated from Quang Nam province and became a city under the central government. The central government's goal was no less than to turn the city into an economic hub for the Central region so as to boost the development of the whole region. According to the geographical and economic conditions in Vietnam as a whole, three focal economic zones were established: the North focal economic zone with Hanoi (and Haiphong) as the center; the South focal economic zone with HCMC as the center; and the Central focal economic zone with Danang playing the central role. Experience with the South focal economic zone showed that HCMC's robust economic growth had spread to neighboring provinces, particularly with regard to foreign direct investment and domestic private investment. Two provinces adjacent to HCMC, i.e. Binh Duong and Dong Nai, have become the country's leaders in GDP and employment growth rates. Policy-makers both at the central level and at the local level hoped that given its new role, Danang's advantages deriving from its geographic location could be further exploited. They hoped that this would add momentum to the city's growth and, more importantly, push the development of the provinces of Quang Nam, Quang Ngai, Thua Thien-Hue and even the coastal provinces of the Central South.

Danang's development since 1997 can be broken down into two stages: (i) stage one, with infrastructure development as a focus during 1997-2000; and (ii) stage two, with the positive impact of the Enterprise Law in 2001-2002.

The Infrastructure Drive, 1997-2000

Despite its new status as a city under the central government with more autonomy in budgetary matters, the city government still considered Danang to be less attractive than the HCMC-Dong Nai-Binh Duong-Ba Ria Vung Tau quadrangle, and the Hanoi-Hai Phong-Quang Ninh triangle. The consensus was that local businesses could not be competitive and the city could not attract foreign investment without sufficient quality infrastructure. And in the years after 1997, Danang moved into a period of massive infrastructure building with a high level of commitment from the city's leadership.[2]

Most importantly, the "infrastructure as a priority" policy was boosted by the increase in budgetary resources made possible by Danang becoming a city under the central government. Instead of having to share an amount of 400-500 billion VND with 15 other administrative units under Quang Nam-Danang province, the city could now enjoy the whole budget sum. In addition, the central government fulfilled its commitments by transferring on average 120 billion VND per year during 1998-2000 directly from the central budget to the city. As a result, infrastructure investment showed a 6-fold rise in nominal terms from 99 billion VND in 1997 to 600 billion VND in 2000, while inflation for the 3-year period was only 8.7%.[3]

The commitment to infrastructure development was most clearly reflected by the Han River bridge project. The bridge crossing the Han River, which divides the city into two areas, was planned with a budget from the central government. However, the Ministry of Transport and Communication invested only 53 billion VND of the total project cost of 95 billion VND due to disagreements over the design of the bridge.[4] The project was completed anyway after the People's Committee of the city added 15 billion VND from local budget and mobilized another 27 billion VND through voluntary contributions from local people.

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[2] The strongest advocate for infrastructure development policy was Mr. Nguyen Ba Thanh, the Chairman of the city's People's Committee. It was due to these efforts that local residents gave him the nickname "Mr. Infrastructure".
[3] In other words, infrastructure investment increased 71.6% per year on average, while the average annual inflation rate was 2.8% during the period 1998-2000.
[4] The city's People's Committee wanted to build a "rotating" bridge so that vessels could pass through easily, but such a design would incur higher construction costs.

The experience in Danang was very different from that of other provinces, where a series of infrastructure projects (especially projects for the widening and upgrading of roads) were delayed due to the failure to reach agreement with households in relocation programs. It can be said that a "command" mechanism was established and increasingly reinforced within the state administrative apparatus from the City People's Committee down to city departments and districts for the purpose of implementing infrastructure and urban planning projects. For instance, in the project for upgrading the stretch of National Highway 1A crossing the city, thousands of households were rapidly relocated with compensation monies funded from the local budget, while construction costs were funded by a combination of central and local budget funds and loans from the World Bank. In projects involving relocation, the city policy was that once 80% of affected households had accepted and agreed to be relocated at the city's compensation rates the projects would be implemented and the remaining households would have to comply. Even with some projects for inner-city road widening, the city adopted a policy to pay compensation for houses, but not for land, gates or fences where the value of the households' remaining land would increase significantly due to the road upgrading. As a result since 1997, around 30,000 households have been relocated, 30 streets newly built, infrastructure upgraded, and urban planning improved. Danang was praised by the central government as being the most efficient area in the country in terms of compensation and relocation.

The international airport and seaport were also enlarged and upgraded. International flights were connected to Hong Kong, Bangkok and Siem Rep. Recently, Danang Port became the third port (after Hai Phong Port and Saigon Port) to be ranked as first class by Vietnam National Shipping Lines (Vinalines). As of 2002, Danang has an infrastructure system comparable to that of other big cities in Vietnam. The city's infrastructure will be further improved in 2005 when many national major projects will be completed such as the Hai Van Tunnel, Tien Sa Port, and the East-West Corridor which links Danang to Southern Laos, North-eastern Thailand, and Burma.

Policy changes after 1997 created a new driving force for the city's efforts to build industrial parks. After a long period of stagnation, three industrial parks with a total area of 861 ha were built after the city government involved itself directly in investing, guaranteeing investments, and pushing relocation and compensation activities (See Box 1).

Box 1: Profiles of Danang's Industrial Parks

Hoa Khanh Industrial Park

Hoa Khanh Industrial Park has a total area under zoning of 425 ha, and was initially invested and developed by a local state-owned enterprise (SOE). However, after years of non-implementation, the City People's Committee took back the allotted land and established an infrastructure development and management company under the Industrial Parks Management Board to carry out the project. All compensation costs for the relocation of over 500 households were covered by the local budget. The infrastructure development and management company built roads and utilities with bank loans guaranteed by the City People's Committee. Interest payable on the loans was also covered by the city's budget. As of late 2002, Hoa Khanh Industrial Park has attracted 68 businesses with a total rented area of nearly 100 ha (accounting for 25.3% of the total area), 8,400 workers employed, and 1,233 billion VND (or 28,2 million US dollars) registered as investment capital. Of the total registered capital, foreign businesses and joint ventures account for 68.4%, and SOEs and private enterprises account for 29.3% and 2.3%, respectively.

Lien Chieu Industrial Park

This industrial park was invested by a central SOE, Industrial Corporation of the Central Region. Total area under zoning is 373 ha. As with Hoa Khanh Industrial Park, the city's government actively supported the relocation and compensation activities and covered half of these costs from the city's budget. All remaining investment costs were funded by bank loans guaranteed by the Ministry of Construction. The Park currently accommodates nearly 20 SOEs with the total area being rented, but with no foreign investment or investment from the domestic private sector.

The city is expecting to attract four large investment projects by central SOEs into Hoa Khanh and Lien Chieu Parks. These are a rubber plant with investment capital of 32 million US dollars from the Vietnam Rubber Corporation; a steel plant with investment capital of 100 million US dollars from the Southern Steel Corporation; a glass and mirror factory with investment capital of 100 million US dollars from the Vietnam Brick and Ceramics Corporation; and a textile plant with investment capital of 58 million US dollars from the Textile and Garment Corporation.

Danang (An Don) Industrial Park

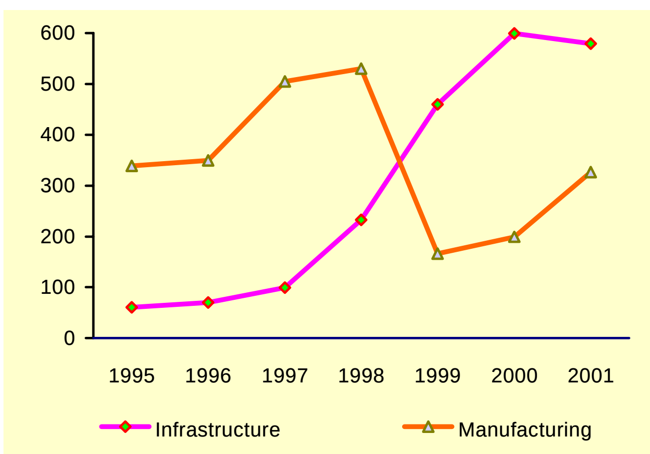
This industrial park is in the form of joint venture between the City's Infrastructure Developing Company and a foreign partner: Massda from Malaysia. The park has a total area of 63 ha. Seven businesses (5 foreign-invested enterprises with total investment capital of 12.9 million US dollars and 2 domestic private enterprises) are operating in the park with a total rented area of 19 ha (accounting for 28.8% of the park's total area).

Hoa Cam Industrial Park

This park was recently approved by the Prime Minister, who signed the decision permitting its establishment in 2003, with a total area of 137 ha and total investment capital of 135.7 billion VND. It is intended that it will become the city's high-tech park.

However, investment in business activities has not matched the increase in infrastructure investment. As indicated in Figure 1, while investment in transportation, utilities and public works showed a continuous increase, industrial investment didn't record any significant increase, and even suffered a sharp decline in 1999.

Figure 1: Infrastructure vs Manufacturing Investments in Danang (VND billion)



Source: Danang's Statistical Office, Danang Statistical Yearbooks, 2000 and 2001.

Since 1995, Danang's annual investment has accounted for 30.6% of its GDP on average, equivalent to the national average. With the sharp increase in budget revenues allowed to be retained by the city after 1997, the share of total investment coming from the state budget rose in both relative and absolute terms, from 18% in 1997 to 57.3% in 2000. It can be said that during the years 1999-2000, Danang's investment structure was mainly derived from the state-owned sector under state-directed programs (including investments from the state budget, policy loans from the Development Assistance Fund and state-owned commercial banks, and investments by SOEs), making up 4/5 of total investment.

Table 1: Danang's Investment by Source

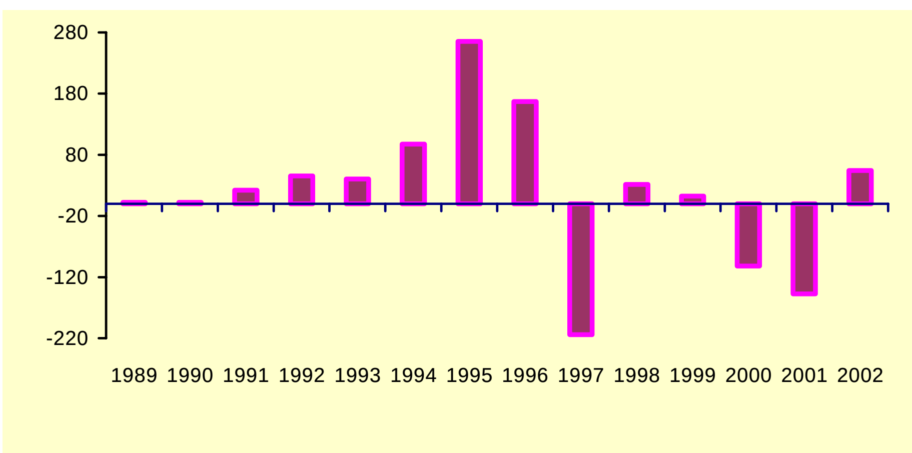
	1995	1996	1997	1998	1999	2000	2001	2002
					Billions of VND			
Total	**858**	**978**	**1088**	**1151**	**1163**	**1285**	**1410**	**2400**
Budget	**110**	**127**	**193**	**210**	**565**	**736**	**300**	**650**
Central government	65	52	70	81	123	167	188	274
Local government	45	75	123	129	443	570	112	377
Directed loans	**144**	**37**	**203**	**86**	**133**	**208**	**230**	**467**
State-owned Enterprises	**192**	**269**	**187**	**68**	**209**	**60**	**254**	**407**
Central	8	137	5	27	158	19	100	126
Local	184	132	182	41	52	41	154	281
Private enterprises and individuals	**163**	**189**	**142**	**226**	**134**	**152**	**455**	**397**
Private enterprises	18	8	22	10	14	11	246	
Individuals	115	181	120	125	100	105	105	
Mixed	30	0	0	91	20	36	104	
FDI	**227**	**356**	**364**	**499**	**46**	**111**	**154**	**275**
ODA	**21**	**1**	**0**	**61**	**76**	**18**	**18**	**204**
					Composition - %			
Budget	**12.8**	**13.0**	**17.7**	**18.3**	**48.6**	**57.3**	**21.3**	**27.1**
Central government budget	7.6	5.3	6.4	7.0	10.5	13.0	13.3	11.4
Local government budget	5.2	7.7	11.3	11.2	38.1	44.3	7.9	15.7
Directed Loans from financial institutions	**16.8**	**3.8**	**18.6**	**7.5**	**11.4**	**16.2**	**16.3**	**19.5**
State-owned Enterprises	**22.4**	**27.5**	**17.2**	**5.9**	**18.0**	**4.6**	**18.0**	**17.0**
Central	0.9	14.0	0.5	2.3	13.6	1.5	7.1	5.3
Local	21.5	13.5	16.7	3.6	4.4	3.2	10.9	11.7
Private enterprises and individuals	**19.0**	**19.3**	**13.0**	**19.7**	**11.5**	**11.8**	**32.2**	**16.5**
Private enterprises	2.1	0.8	2.0	0.9	1.2	0.8	17.4	
Individuals	13.4	18.5	11.0	10.9	8.6	8.2	7.4	
Mixed	3.5	0.0	0.0	7.9	1.7	2.8	7.3	
FDI	**26.5**	**36.4**	**33.5**	**43.4**	**3.9**	**8.6**	**11.0**	**11.5**
ODA	**2.5**	**0.1**	**0.0**	**5.3**	**6.6**	**1.4**	**1.3**	**8.5**

Source: Danang Statistical Office, Danang Statistical Yearbooks, 2000, 2001 and 2002.

By 2000, Danang's investment picture showed a strong contrast between domestic private investment and state-owned sector investment. Domestic private investment as a proportion of total investment fell from 19% to 12% during the same period. Moreover, a major part of it was investment by individuals and families in small trading businesses or in real estate. During the period 1995-2000, investment by private enterprises averaged 1.3% of total investment.

Between 1998 when the Law on Foreign Direct Investment was passed and the end of 2002, Danang attracted 46 foreign-invested projects with a total registered capital of 277 million US dollars. This is lower than the value of new foreign investment capital registered in a single year during 1998-2002 in Binh Duong or Dong Nai.[5] Figure 2 shows the continuous decline in foreign direct investment. A series of investment projects in Danang were withdrawn in 1997 when the Asian financial crisis hit. Except for a number of small export-oriented projects such as toy and garment manufacturing and seafood processing, the majority of manufacturing projects are in import-substitution industries such as pulp and paper, plastic, engineering, and hotel, construction and infrastructure projects.

Figure 2: Foreign Direct Investment in Danang
(registered capital in USD million, excluding rescinded projects)



Sources: Danang's Statistical Office; Danang Statistical Yearbooks 2000 and 2002; and Socio-economic Development Report 2002 of Danang City's People's Committee.

[5] Foreign direct investment capital registered in Binh Duong for 2001 was 298 million US dollars and increased to 400 million US dollars in 2002.

The easiest explanation for the decline in both domestic private investment and foreign investment is the country's overall slow-down in economic growth after the Asian financial crisis. Yet clearly policies played some role. Traditionally, the central provinces in general and Danang in particular have been perceived as a business-unfriendly location. This image has remained almost unchanged in the late 1990s and early 2000s.

Danang's 1997-2000 investment structure seemed to suggest a typical instance of state investment crowding out private investment. But Figure 2 shows that investment by SOEs in Danang did not increase compared to the early 90s. SOEs share of total investment actually fell from 25% during 1995-1996 to 11.4% during 1997-2000. That is to say, there was no crowding out effect by SOE investment in manufacturing and services against domestic private investment. So, what is the real explanation behind the inverse relationship between state investment in infrastructure and domestic private investment?

As mentioned above, the policy focusing on infrastructure development created a bureaucratic apparatus based on administrative measures and "command" mechanisms. As a result, not only public works and urban planning projects but also private enterprises have become subject to these mechanisms. One banker in Danang has said that, many economic relations, especially lending activities, can be criminalized. The risk of violating laws, therefore, is much higher for businesses in Danang than their counterparts in other provinces. A businessman in Danang has observed that the city's policy environment "destroys the dynamism and flexibility of business activities."

As long as the city's government focused all its resources on 'hard' infrastructure, efforts to attract foreign investment and develop the private sector ('soft' infrastructure) were neglected.[6] Of course, it is not a case of simply one or the other, of either infrastructure or private investment, but an extreme bias could have a negative impact. In the context of an imperfect institutional framework and policies, businesses in

[6] This has happened even with HCMC. After a decade of rapid economic growth in the 1990s, HCMC's infrastructure became more and more jammed and overloaded, especially the traffic, waste water and solid waste treatment systems. The City's shift of focus to addressing infrastructure issues prompted concern among the foreign-invested enterprise community that HCMC might focus less on activities to attract investment and economic development.

Vietnam encounter numerous difficulties in obtaining business licenses, land, and bank loans, and in taxation and customs issues and so on. A review of success stories in places like Binh Duong and Dong Nai shows that the provincial people's committees and their departments in these areas regularly make efforts to address difficulties encountered by businesses on a case-by-case basis. While the policies of the central government still give rise to many such administrative 'knots', Danang has not taken any initiatives similar to the "fence-breaking" practices adopted in the south eastern provinces.

For a better insight into Danang's policy choice, one should compare this city with Binh Duong province. It can be said that Binh Duong's success is due to its proximity to HCMC and that it has been able to exploit the advantages of cheap land rents, a good transport system, a sufficient supply of skilled labor and business support services from HCMC in its efforts to attract investment. Therefore, according to this line of reasoning, it does not make sense to compare Binh Duong with other provinces. In fact, other provinces in close proximity to HCMC and with better advantages than Binh Duong (such as Tay Ninh or Long An) have not succeeded and thus policies clearly played an important role in the economic growth results posted by Binh Duong, as analyzed below.

Much like Danang, Binh Duong province was established from provincial separation. Before 1997, Binh Duong was part of Song Be, a province neighboring HCMC. However, unlike Danang, Binh Duong was basically an agricultural province upon separation, though possessing a socio-economic base better than that of the rest of Song Be. Aside from its proximity to HCMC, Binh Duong has neither a strategic location, nor important infrastructure facilities such as an airport or seaport, nor a significant presence of major SOEs.[7] Therefore, the provincial government found it impossible to lobby for more budget and investment from the central government. Relying on state-owned sector investment for development of the province was unfeasible, while its leadership was very ambitious to lift the province to prosperity. Attracting foreign direct investment and domestic private investment (especially investment from HCMC) became the only policy option available to the provincial government. Over time, the policies and economic performance of Binh Duong have complemented one another, and its leadership can see more clearly that Binh Duong's prosperity in the future depends on private enterprises and foreign-invested enterprises manufacturing products with internationally competitive prices. However, it should be recognized that the option taken by the Binh Duong provincial leadership was not without political risks. In the late 1990s, in order to attract foreign investment and domestic private investment, the provincial people's committee had to take direct action to untie administrative knots for specific investors [8] and implement decisions on land and credit matters for the private sector beyond the general framework of national policies. The official investigation into the provincial government's allotting land to a private enterprise to develop an industrial park in 2000, just a few years after the industrial park became operational, is a good illustration of this risk. However, by reviewing the economic structure in which SOEs played an insignificant share and thanks to the cohesion among Binh Duong's leadership from the people's committee to its departments, the province made a reasonable decision in 1997 to take risks on the new road.

In 1997, Danang faced the same choices as Binh Duong. In contrast to Binh Duong, Danang has a strategic location and the importance of being a major city in central Vietnam, relying on state investment for development became a safe haven for the city's leadership. Quang Nam-Danang has a proud revolutionary tradition from the wars. Within the city's key circles of power, there are many elderly revolutionaries opposed to possible policies aimed at promoting the private sector; these people still hold great influence in the city's party committee and in organization and human resource management. During a meeting with writers and composers, the Chairman of Dang Nang People's Committee made the comment: "chairmanship of the city people's committee is a career full of risks."

In summary, despite the fact that little foreign direct investment has been realized and insignificant development achieved by the private sector, Danang's economic

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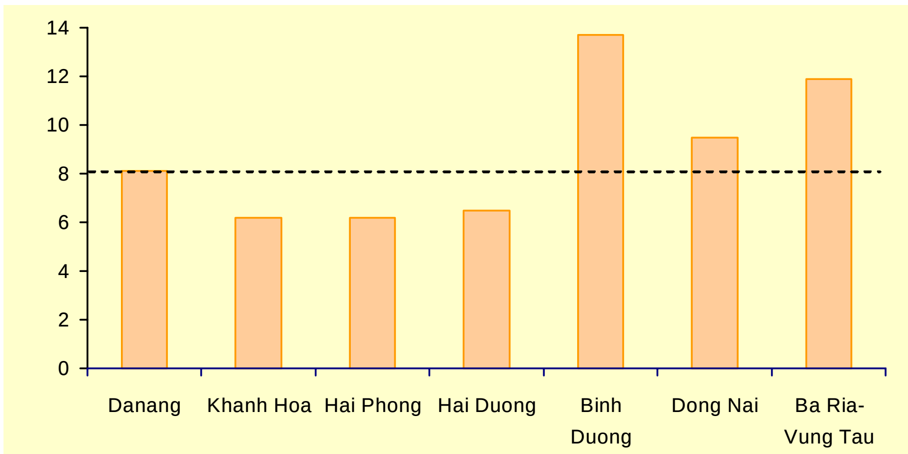
[7] As a joke, Binh Duong also has a river, but it is "Song Be" River (Song Be is the name of the former extended province).

[8] Businesses in Binh Duong can call the Chairman of the People's Committee directly on his mobile phone to inform him of obstacles they are encountering and soon afterwards relevant departments of the province will be instructed by the Chairman on how to sort out the problems of the business concerned.

growth has been kept on track by investment expenditure from the state sector. Danang's real GDP grew at an average rate of 8.1% during the period 1995-2000. Figure 3 shows that the growth rate, though higher than most other northern and central provinces, was much lower than that of Binh Duong, Dong Nai, or Ba Ria-Vung Tau.

Figure 3: Real GDP growth rates of selected cities and provinces in Vietnam during 1995-2000



Source: Vietnam General Statistics Office.

Another point to bear in mind is that, unlike with figures on investments or exports, one should be cautious when using figures on GDP or value of industrial output. Reported figures for GDP of all provinces in Vietnam are higher than actual. The growth rates shown in Figure 3 were based on data from the Vietnam General Statistical Office, and had been adjusted downward from the original reports submitted by the provinces. For instance, the average growth rate shown for Danang of 8.1% per year is nearly 3% lower than the official growth rate reported by the Danang People's Committee at 11% per year. But even figures reported by the General Statistical Office are considered to be over-stated. Growth rates for Vietnam's GDP cited in IMF reports are typically 2% lower than the official figures of the government. In our analyses, we usually use Vietnam's offical figures have been used as a high estimate and the IMF's figures as a low estimate. Thus, Danang's economic growth during the period 1995-2000 probably lies in the range 6-8% per year.

Danang's Economy after the Enterprise Law, 2001-2002

The 2000 Enterprise Law removed entry barriers for private enterprises nationwide. There is no doubt that the Law has had a stronger impact on provinces where the private sector used to be depressed, especially in northern and central provinces like Danang, as compared to provinces in the Southeastern region where private enterprises already had comparative economic freedom. In the two years 2000 and 2001 alone, 955 private enterprises were established, nearly 1.3 times the total number of private enterprises set up previously. Table 3 shows that investment by the private sector in 2001 rose nearly three fold over 2000, of which investments by economic entities established under the Enterprise Law increased from 11 to 246 billion VND. Economic growth in 2001 reached 9,2%.[9]

Freeing up the right to do business is a necessary step, but not sufficient in itself. Private enterprises still face many difficulties in dealing with regulators, and in getting access to necessary resources such as land and capital. Box 2 shows that private enterprises in Danang face high risks from arbitrary policies, and are seldom protected when competing directly with SOEs.

Box 2: La Rue beer and Saigon beer

The brewing industry is a major source of tax revenue for many provinces. As a result, except for remote and mountainous areas, most provinces and cities in Vietnam have established SOEs or joint ventures between a state entity and a foreign partner to produce beer. La Rue Brewery is in Danang. Due to La Rue's poor pricing strategy in 2001 and 2002, consumers in Danang have gradually been shifting to drinking Saigon beer.

After campaigns in the mass media appealing for support for La Rue beer ended in failure, Danang's 'strong' administrative apparatus was put into action to secure market share for the "city's beer". Saigon beer dealers told us that visits by the tax authorities suddenly became more frequent. By double checking they came to know that tax officers were under orders to check Saigon beer wholesalers to find out whether tax evasion had helped them to sell Saigon beer at a cheaper price than La Rue beer.

[9] The official figure from the Danang Statistical Office is 12.2%. According to the adjustment rule of thumb mentioned above, the corresponding figure from the General Statistical Office is 9.2% (and the IMF's corresponding figure is 7.2%).

The issue of land has increasingly become an obstacle for enterprises. Statistics from the Danang Land and Housing Department shows that, due to historical factors, the private sector is facing big obstacles in land issues. In previous years, many private economic entities had been established in the form of collectives or cooperatives in order to avoid the taboo word “private”. These entities purchased land with money contributed by their members (or "shareholders"). However, later on Danang’s revised general land policy ordained that land under the collectives or cooperatives belonged to the state; those who wanted to change to enterprise status would have to rent the land from the state if they wished to continue using it.[10] A private enterprise finds it difficult to rent a land lot in an industrial park unless it has a big investment project. Moreover, preferential land rental rates are mostly applied to SOEs and foreign-invested enterprises. Private enterprises often rent land from SOEs. According to the Land and Housing Department, on top of rents, those private enterprises who want to rent land in a certain district typically contribute (50 to 100 million VND) to the district government in the form of computers and office equipment or supplies.

The Danang branch of the Development Assistance Fund is a major source of long-term investment capital, but the entire loan fund, normally loaned at a preferential interest rate of 3% per year, is reserved for the state-owned sector. The city’s assistance funds also favor SOEs; they usually lend from the budget surplus retained by the Treasury[11] or from the City Enterprise Assistance Fund at an interest rate of 2.4% per year.[12]

Loans from Danang’s banking system are, for the most part, concentrated on SOEs, especially infrastructure developers. Up to and including 2001, loans to the private sector only accounted for 21.5% of total outstanding loans.

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[10] This was where Binh Duong adopted “fence-breaking” measures when it allowed private enterprises to rent land.

[11] According to Danang’s Finance-Pricing Department, making loans from the budget surplus retained by the Treasury means borrowing from the state budget and, so far, there have not been any official documents in place which allow private enterprises to borrow from the state budget. However, HCMC's economy reveals that state budget capital, if used for enterprise assistance purposes (such as investment guarantee), can be applied to all economic sectors.

Table 2: Commercial Bank Loans

	1997	1998	1999	2000	2001
			Billions of VND		
Loan outstandings	**2270**	**2711**	**3185**	**4239**	**5464**
SOEs	1530	1897	2685	3510	4289
Private sector	740	814	500	729	1175
Agriculture	…	254	499	924	795
Manufacturing	…	621	506	759	1025
Construction	…	658	926	992	1250
Trading & other services	…	511	661	873	1255
Transportation & Telecommunication	…	266	253	263	190
Others	…	401	340	428	949
			Composition - %		
Loan outstandings					
SOEs	67.4	70.0	84.3	82.8	78.5
Private sector	32.6	30.0	15.7	17.2	21.5
Agriculture	…	9.4	15.7	21.8	14.6
Manufacturing	…	22.9	15.9	17.9	18.8
Construction	…	24.3	29.1	23.4	22.9
Trading & other services	…	18.8	20.8	20.6	23.0
Transportation & Telecommunication	…	9.8	7.9	6.2	3.5
Others	…	14.8	10.6	10.1	17.2

Source: State Bank of Vietnam – Danang Branch.

The major advantage enjoyed by SOEs in obtaining loans is guarantees by various levels of government. If the SOEs are unable to repay their loans, the banks will arrange for rescheduling or ever-greening, or budget transfers. In addition, the lack of collateral available to enterprises in Danang is a considerable obstacle for commercial banks to extend credit to the private sector. Though trust lending (loans without collateral) is allowed by the State Bank, commercial banks are reluctant to extend credits under this form for different reasons. First, Vietnam's bankruptcy law is considered to be too debtor-friendly, and it is almost impossible for creditors to force their borrowers to declare bankruptcy and liquidate their assets (See Box 3). Even with loans secured by collateral, in many cases, it is impossible for the banks to sell default borrowers' assets rapidly to recover their loans. Even though this is a nationwide issue and beyond the control of a particular province, different levels of government have full capacity to help accelerate bad asset recovery processes for the banks. Second, as

[12] The city people's committee set up the Enterprise Assistance Fund in 2000 from local budget source and revenue from equitizing (privatizing) SOEs. Investment projects appraised and approved by the

mentioned above, though a civil contract, a loan contract is usually criminalized when the borrower does not honor his debt-service obligations. A banker may be dismissed (or even imprisoned) if a loan given by him to a private business becomes a bad debt.

Box 3: Bankruptcy Law

Under the Vietnamese bankruptcy procedure, if a creditor submits an application forcing an enterprise to declare bankruptcy, then the creditor has to prove the bankruptcy situation of the enterprise. However, in order to satisfy the conditions of bankruptcy, the enterprise has not only not to have paid its due debts but also has to have incurred losses for two consecutive years, and after having implemented necessary financial measures, still be unable to pay the debts due. Banks cannot afford to prove these conditions.

In addition, the bankruptcy procedure requires both the creditor and the debtor to undergo reconciliation in order to identify restructuring measures. Where restructuring is adopted, the existing director is allowed to continue managing the enterprise. The assets of the enterprise can be liquidated only when no agreement can be reached. So, developing restructure plans is a statutory phase even when both the creditor and the debtor wish to liquidate assets right away.

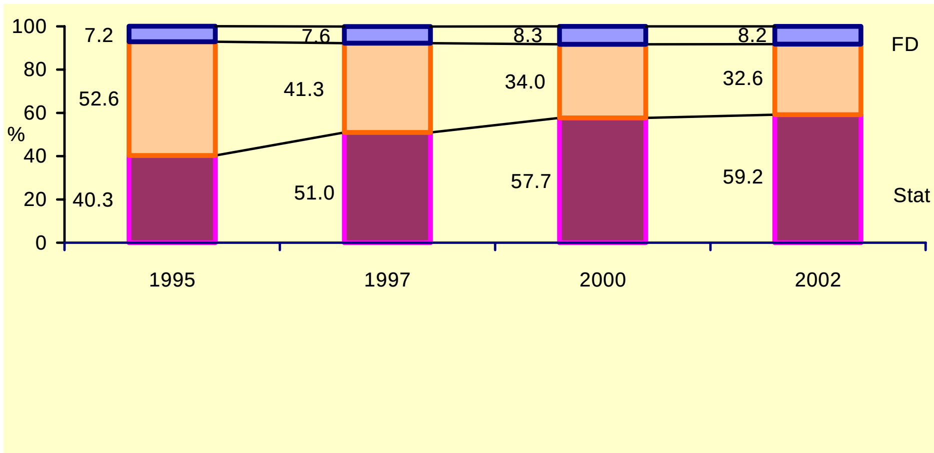
In summary, up until 2002, Danang's economic growth, driven by massive state investment, especially in infrastructure, has not been successful. Despite its strategic geographic location, high quality infrastructure and the many incentives created by the 2000 Enterprise Law, in Danang the outlook for both foreign direct investment and domestic private investment is still bleak; with an unfriendly business environment being one of the main reasons.

Figure 4 shows that the rise in the share of the state-owned sector offsets the decline in the share of the private sector, while the share of the foreign-invested sector exhibits very modest growth. This picture contrasts with Binh Duong, Dong Nai and HCMC where the rise in the share of the foreign-invested sector offsets the decline in the share

Finance Department and SOEs are the only beneficiaries.

of the state-owned sector. Once again, Danang faces the challenge of policy options for economic development.

Figure 4: Composition of Danang's Total Output by Types of Ownership



Source: Danang Statistical Office, *Statistical Yearbook 2000*, 2000

The questions we need to ask are: whether Danang can continue to maintain (or accelerate in the long run) its growth by relying on the state budget and SOE investment; what impacts promoting foreign investment and domestic private investment will have on the city; and what changes in the policy environment should be made in order to attract the expected investment? This paper addresses these questions by suggesting and analyzing three alternative policy scenarios for Danang in the coming years.

Three Policy Scenarios

1. Continue investing in the state sector

Policy scenario 1 is for Danang to continue with the same investment strategy as in past years. This strategy is in line with the city's master plan for socio-economic development till 2010. In line with this policy, Danang will continue to develop its infrastructure evenly, and build the city into a major center for the marine economy of the region. An important part of the plan is for Danang, during 2001-2005, to develop with the following focii: first, industry; second, services; and third, agriculture.

Specifically, the state-owned sector is expected to focus its investment aggressively on industries like textiles, seafood processing, engineering, electronics, construction materials, and shipbuilding.

It is necessary first to examine the feasibility of relying on the state budget in the coming years. After such a massive investment in infrastructure, Danang is under increasing pressure from the central government to perform better. The whole process starts with the need to change the structure of central government budget redistribution and allocation. For many years, the central government adopted a policy to redistribute a major part of the tax revenues collected in Hanoi, HCMC, Binh Duong, Dong Nai and Ba Ria-Vung Tau and re-allocate such revenues to poorer provinces.[13] Recently, HCMC and neighboring provinces have been lobbying aggressively for a higher rate of budget retention, so that they can resolve pressing problems with poor and over-loaded infrastructure and services. As evidence of the lobbying pressure, the central government delegated special status to HCMC in 2001, where the city can retain a higher share of its budget revenues and has more autonomy in managing its budget, investment and urban plans. In the near future, the central government can only provide budget assistance to disadvantaged provinces in remote and mountainous areas; privileged provinces like Danang will have to manage on their own. Table 2 shows that Danang's capital from budget source in 2001 actually fell as compared to 2000.

Therefore, its growth strategy will largely rely on SOE investment. Big projects invested by state-owned corporations in industries like steel, glass, ceramics and textiles which the city is trying to attract into Hoa Khanh and Lien Chieu industrial parks (See Box 1) seem to reflect the trend. But the experiences of many places have shown that state-directed investment is rarely successful in the absence of objective appraisal based on technical criteria. Except for stimulating one-time surges in aggregate demand, these projects will soon erode resources and hamper the city's growth. Unlike previous periods when the state invested in infrastructure, investing in major SOE projects will be a big political risk for the city's leadership.

[13] During 1997-99, up to 80-85% of total budget revenues collected in HCMC were transferred to the central government.

The situation is actually even more complicated because even if the risk were identified, it would still be difficult for the city's leadership to cancel projects listed in the investment program and supported by SOEs with political influence. In this respect, HCMC has had invaluable experience in investment planning with rigorous procedures and the ability to stop inappropriate projects even in the context of political pressure.

During 1994-95, HCMC started to prepare a master plan for socio-economic development till 2010. The master plan was completed in 1996 and revised in 2000 due to major changes in the domestic and international economic environment since 1997. Based on growth orientation and economic structural change, the master plan identified industries on which growth efforts were to be concentrated, of which mechanical manufacturing was put at the top of the list. The need to develop mechanical manufacturing seemed even more urgent as HCMC had to play a leading role in the industrialization process. The target program to develop mechanical manufacturing was introduced by the Industry Department of HCMC by recommending the establishment of a state-owned engineering corporation under the HCMC People's Committee. Total project cost was to be 100 million US dollars for the 2001-2005 period and another 300 million US dollars for 2006-2010. The project aimed to make uniform new investments to establish dominant engineering enterprises (affiliates), meeting important requirements from research and development, design, raw steel production, heat treatment to precision fabrication. The corporation was also to be responsible for planning, assigning operational functional areas to its affiliates, and investing for modernization with considerable specialization in the major mechanical products in great demand from the city's industrial sector. However, when the program was brought up for discussion with the participation of central and local state agencies, scientific research institutes, universities and businesses, there were many comments citing the fact that such a corporation would be unable to manufacture products at world prices and unable to compete with Chinese products. The whole program, therefore, was stopped.

2. Create a favorable and fair business environment

Another policy scenario is, instead of focusing on implementing SOE projects, the Danang People's Committee can concentrate its efforts on creating a level playing field for businesses and a competitive environment for domestic private investment activities. This is the route which Binh Duong, and to a lesser extent Dong Nai, are taking. The emergence of the private sector in Danang after the passing of the Enterprise Law illustrates that the city is not short of enterpreneurship and its private sector has the potential to thrive if placed in a favorable business environment.

The first step could be creating a positive image for the government by holding regular meetings with businesses. In addition, the city should have a division in charge of solving problems for individual businesses. Actually it can be seen that Danang has a strong bureaucratic system where the People's Committee's policies and directions are well enforced by subordinate agencies. This is, in fact, an advantage Danang has over many other provinces in Vietnam. Enterprises we interviewed in Danang shared the same view that should the city's government ever want to resolve difficulties for businesses things would be sorted out right away. The story of Furama resort is an example where the people's committee addressed the issue between a foreign investor and the local police in a timely and effective manner (See Box 4). It is quite apparent that Furama is a large-scale foreign-invested project and it is the starting point for the city's efforts to develop tourism. The leadership and regulatory agencies were fully aware of the benefits to be derived from resolving the difficulties for Furama. Danang's economy would be much better should state regulatory agencies fully recognize the benefits from promoting the establishment of domestic private enterprises and helping remove obstacles to their development. In short, the necessary change is in state management views and in the policy-making process within the city's bureaucratic system towards a more business-friendly attitude.

Box 4: Furama Resort Project

Furama Resort is a foreign-invested project with total investment capital of 40 million US dollars. Right on the grand opening day in March 1997, Furama was inspected by the police. Upon receiving a complaint from the managing director, the Chairman of the City People's Committee issued a decision stating that all inspection and supervision activities regarding this resort must have approval in writing by the People's Committee. This sent out a strong signal from the People's Committee to other state regulatory agencies showing the support of the city's leadership to Furama. 'Harassment' actions against the resort were stopped. So far, Furama has been the most successful of all hotel-tourism projects in Vietnam.

The next steps, which are more challenging, include: (i) removing barriers to resources like land and credit for private enterprises; (ii) developing business associations; and (iii) developing a system to rank the competitiveness and attractiveness of the city's business environment against those of other localities based on criteria such as quality of infrastructure and the quality of public services, including licensing process, taxation, customs, financial services and the training and education system.

Compared with scenario 1, this scenario in fact still aims to push the development of processing industries, but differs in that the players are private enterprises while the state plays the role of a facilitator. A favorable business environment combined with a good infrastructure system, including technical and financial services, research institutes, education and training institutes, will serve as the base for the gradual formation of industrial clusters. Typically, the formation of an industrial cluster is a natural process coming about through the establishment of a number of domestic or foreign enterprises in the same industry. This will lead to the development of suppliers and business support services providers. As a result, businesses will be competing fiercely with one another in the same product market, but at the same time share technology and the relations with input suppliers, support services and distribution channels. Thanks to the synergy, an industrial cluster can provide businesses with the capability to manufacture highly competitive products.

However, it is very difficult for the state to develop plans to establish industrial clusters, as the process requires the coordination of a series of complicated elements including strategic leadership, networking, capacity building and market research. In practice, many of Vietnam's policies actually hamper this process. The policies for equal investment and quota allocation make an industry's production capacity spread over many provinces. Industrial parks are typically organized into different functional zones, thus creating gaps in the information sharing process among businesses.

Therefore, a level playing field in a competitive environment with a minimum level of distorting policies will provide the best conditions for industrial clusters to be nourished. However, this is obviously not a sufficient condition on its own. Even in HCMC, Binh Duong and Dong Nai, no solid industrial clusters have emerged.

Taking a look at the picture of industrial development outside Danang, Quang Nam seems to be a more attractive destination. In 2001, Quang Nam for the first time attracted 5 foreign-invested projects with a total capital of 15 million US dollars. The figure rose to 39 million US dollars in 2002 and 21 million US dollars in the first quarter of 2003 alone. Many private enterprises in Danang have shifted to Quang Nam to rent land and build plants there, including Hai Vy Co. Ltd, a seafood processor for export. It should be noted that though shifting to Quang Nam to build its processing plant with lower land rents, Hai Vy still maintains its trading activities in Danang. This suggests a third policy option for Danang, which is to turn the city into a service center, supporting manufacturing activities in neighboring provinces.

3. Develop the city into a service center

Comparing the Central focal economic zone to the Southern focal economic zone, Danang's role is comparable to that of HCMC: the service center of a region. In terms of cheap land prices for industrial development, HCMC cannot compete with Binh Duong and Danang cannot compete with Quang Nam.

Actual figures show that among all the enterprises established in Danang under the new Enterprise Law, 68% are trading businesses. However, the challenge for Danang is to develop production-supporting services like finance, specialized and import-export services.

Currently, the city's exporters incur higher transport costs than their counterparts in the north (through Hai Phong Port) and in the south (through Saigon Port). Danang's exports turnover during 2000-2002 fluctuated within the range of 250-280 million US dollars. Apart from tourism, Danang's exports are concentrated in a few industries like seafood processing, handy-craft, garment and footwear. Low volumes of exports from Danang mean that ships do not often call at Danang Port, and hence transport costs rise. This leads to vicious circle: low exports leading to high transport costs through the port, and then high transport costs becoming an obstacle to exports. However, exporting through Saigon Port is an alternative. Comparing the two ports, the average transport cost for a 20-foot container at Danang Port is 300 US dollars more expensive than the cost at Saigon Port. Choosing Saigon Port as an alternative would cost another 385 US dollars to transport the container from Danang to HCMC, but the shipment would be one week faster. Therefore, Danang's exporters, especially in processed seafood, still choose the alternative of exporting through Saigon Port.

The social infrastructure in Danang still has much room for improvement. Foreign investors in Danang agree that the city's quality of life is poor because it lacks modern hospitals, international schools and other social utilities. This is a big obstacle hampering the city's efforts to attract investment from the multinationals. In the near future, attracting small-scale export-oriented foreign-invested projects may be more appropriate for Danang. A policy breakthrough for foreign investment was announced by the City People's Committee in March 2003, whereby projects invested in industrial parks of up to 5 million US dollars of investment will be licensed automatically on-line. The city's government will bear all the costs of land clearance and relocation and pay 50% of damages to assets on the respective land; and foreign investors will enjoy a single price system as Vietnamese nationals in using public utilities in the city.

Conclusion

In summary, Danang has made a good start by building hard infrastructure and beginning to address "soft" infrastructure for foreign investors. It needs to continue along this line, finding ways to expand fair opportunities for domestic private investors so they are more nearly treated equally with the currently favored state sector. If Danang can do this, with its history of conservative attitudes towards the private sector, then many other places in Vietnam can do it too.

If provinces learn not to "call" for investments in which they specify the output, scale, and partners for the foreign investor but instead work to attract investors by lowering costs, much can be achieved. If they learn to think of domestic investors as being more important in most cases than foreign investors, at least in the aggregate, they will begin to do more sensible things that some provinces have already done. In short, provincial level management is the key to growth. The Center can open the door, but the province has to make sure there is no barrier to the door and that the path is smooth. It is the individual firm that actually walks through the door.

A question, however, remains is that how to get provinces such as Danang started to think and act in the above direction. Is it by pure chance that Binh Duong chose the FDI and private investment path while Danang and many other provinces opted for the state investment-led growth? In this area, the national government certainly has a role to play by changing incentive structure facing provincial leaders. The current investment allocation policy of the central government is to reward less successful provinces with more money and punish more successful ones with less. Recall that Binh Duong was not in a position to ask for state investment in the first place. And as it becomes more and more successful in attracting private investment, the central government feels that even less state investment is needed for the province. In contrast, many provinces in the northern and central regions cannot attract any significant private sector money, and the central government, therefore, is under the pressure to invest state money in these provinces as a substitute for private investment. If state investment can be used as a complement to, rather that a substitute for, private investment,[14] then leaders in many provinces of Vietnam will have an incentive to switch policies just like Binh Duong did some six years ago.

Changing attitudes alone, however, cannot ensure success. The policy makers at the local level have to stay focused. The lack of an effective system of governance and a strong legal framework means that unexpected problems often occur for businesses, whether being foreign or domestic, even though the government remains committed to supporting the private sector.[15] To ensure that these problems can be effectively solved, they need to be identified first. This can be done by ranking local business friendliness. Just as Vietnam needs to benchmark itself against other leading nations in the region, a province like Danang will have to compare itself to other provinces, especially those successful ones.

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[14] That is, those provinces successful in attracting private investment will be rewarded with additional state investment in infrastructure development. This policy, of course, cannot be applied to provinces in a truly difficult situation, such as those in remote and mountainous areas. But many provinces in Vietnam are not in the remote and mountainous areas. In fact, they are coastal provinces, just like the eastern coastal region of China. They can surely become more successful if the incentive structure is right.

[15] Ho Chi Minh City is an illustrating case in point. After more than decade recording rapid economic growth with a reputation of the most business friendliness place in Vietnam, HCMC started to experience the problem of infrastructure overloading in the beginning of the new millenium. As the local government's resources are geared towards solving traffic jams, flooding, and solid and water waste treatment problems, its investment environment worsens steadily and investors have been expressing concerns about problems that reapprear in areas of taxation, customs, and liscencing.

The changing state investment policies of the central government and the changing local government attitudes and policies towards the private sector can reinforce each other. With the right kind of pressure and incentives from the central level, local leaders will find that it is in their provincial as well as their own interests to try to get economic growth from real value creation in the private sector. More successful provinces, in turn, will relieve the central government from the need to build sugar, cement or steel plants for the provinces. The overall efficiency of investment allocation in the country will be improved, enabling the whole country and provinces to reap benefits of greater economic integration with the world economy.