

ISSN 0219-3213

2014 #04

Trends in  
Southeast Asia

REFORMS WILL DETERMINE DEGREE OF  
VIETNAM'S DEPENDENCE ON CHINA

JOHN LEE



ISEAS Publishing

INSTITUTE OF SOUTHEAST ASIAN STUDIES

# Trends in Southeast Asia

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Published by: ISEAS Publishing  
Institute of Southeast Asian Studies  
30 Heng Mui Keng Terrace  
Pasir Panjang, Singapore 119614  
publish@iseas.edu.sg <http://bookshop.iseas.edu.sg>

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### **ISEAS Library Cataloguing-in-Publication Data**

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Lee, John.

Reforms will determine degree of Vietnam's dependence on China.  
(Trends in Southeast Asia, 0219-3213 ; TRS 4/2014)

1. Vietnam—Economic policy.
2. Investments, Chinese—Vietnam.
3. Investments, Foreign—Vietnam.
4. Vietnam—Foreign economic relations—China.
5. China—Foreign economic relations—Vietnam.

I. Title.

II. Series: Trends in Southeast Asia ; TRS 4/2014.

DS501 I59T no. 4(2014)

2014

ISBN 978-981-4519-83-0 (soft cover)

ISBN 978-981-4519-84-7 (e-book, PDF)

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Typeset by Superskill Graphics Pte Ltd

Printed in Singapore by Mainland Press Pte Ltd

# FOREWORD

The economic, political, strategic and cultural dynamism in Southeast Asia has gained added relevance in recent years with the spectacular rise of giant economies in East and South Asia. This has drawn greater attention to the region and to the enhanced role it now plays in international relations and global economics.

The sustained effort made by Southeast Asian nations since 1967 towards a peaceful and gradual integration of their economies has had indubitable success, and perhaps as a consequence of this, most of these countries are undergoing deep political and social changes domestically and are constructing innovative solutions to meet new international challenges. Big Power tensions continue to be played out in the neighbourhood despite the tradition of neutrality exercised by the Association of Southeast Asian Nations (ASEAN).

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# Reforms Will Determine Degree of Vietnam's Dependence on China

John Lee

## EXECUTIVE SUMMARY

- Defined by its geography, the troubled history between the two countries, and the huge asymmetry of power, Vietnam pursues a counter-dominance strategy towards China even as it adopts a softly-softly diplomatic approach with its northern neighbour.
- Over-reliance on a far larger Chinese economy and the possibility of China economically punishing Vietnam for strategic policies is a genuine concern for Hanoi and questions the degree to which its counter-dominance strategy vis-à-vis China can be sustained.
- While China has emerged as Vietnam's largest trading partner by volume and Vietnamese dependency on Chinese imports is growing, deeper analysis of the nature and structure of trade between the two countries suggests that China's capacity to use trade to enhance its strategic leverage over Vietnam is far more restricted than is often assumed – and any attempts by Beijing to use the trading relationship for strategic gain would impose considerable costs on China.
- Likewise, Vietnamese reliance on Chinese capital in the form of foreign direct investment is narrow and limited to a small number of sectors – denying Beijing significant strategic leverage over Hanoi on account of the role and importance of Chinese capital in Vietnam.
- However, a failing economic reform process will cause other foreign firms and external capital to lose interest in the Vietnamese economy. This would deliver a considerable blow to Hanoi's attempts at balancing and mitigating the influence of China by way of lessening currency and increased future reliance on Chinese trade, investment and other forms of state largesse, such as concessionary loans and aid.





# Reforms Will Determine Degree of Vietnam's Dependence on China

John Lee<sup>1</sup>

## INTRODUCTION

Vietnam's relationship with China is largely shaped and defined by its geography, the troubled history between the two countries going back for thousands of years, and the enormous asymmetries in size, population and power.

In terms of geography, if one likens China to the shape of a rooster, the Korean peninsula forms the Chinese beak and Vietnam – which shares a 1,300 kilometre border with China – forms the rooster's leg.<sup>2</sup> It is no wonder, then, that many commentators argue that Vietnam has always faced the 'tyranny of geography' since its emergence as an independent political entity in the first century.<sup>3</sup> Historically, between the first century BC and fifteenth century, Vietnam was subject to four periods of Chinese domination. In more recent times, despite a period of ideological comradeship from 1949-1978, the 1979 border war

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<sup>2</sup> See Le Hong Hiep, "Vietnam: Under the weight of China," *East Asia Forum*, August 27, 2011 <<http://www.eastasiaforum.org/2011/08/27/vietnam-under-the-weight-of-china/>> accessed February 13, 2014.

<sup>3</sup> See Carlyle Thayer, "The Tyranny of Geography: Vietnamese Strategies to Contain China in the South China Sea," Paper to international Studies Association 52<sup>nd</sup> Annual Convention, Quebec, Canada, March 16-19, 2011 <[http://www.viet-studies.info/kinhte/Vietnam\\_Strategies\\_China\\_Thayer.pdf](http://www.viet-studies.info/kinhte/Vietnam_Strategies_China_Thayer.pdf)> accessed February 13, 2014.

between the two countries, which resulted in up to 30,000 casualties, is still a defining event for Vietnam. In the contemporary period, China's economy is over fifty times bigger and has an official defence budget (which is almost certainly understated) more than 32 times larger than Vietnam's, according to 2012 figures.<sup>4</sup>

The enduring nature of the first two factors – geography and history – means that China's recent re-emergence as arguably Asia's greatest power is simply a return to a precarious state of affairs that Vietnam has long confronted throughout history. Likewise, the contemporary asymmetry of power between the two countries is neither new nor unexpected as far as Hanoi is concerned.

Even so, the contemporary economic and strategic terrain of Asia within which China is rising introduces some new factors. In important respects, China's economy is deeply integrated with all other major economies in Asia, and China is itself already entrenched as an economic epicentre for Asia. The continuation of China's economic rise is profoundly important for all major political and strategic players in Asia, including the United States, Japan, South Korea and all ASEAN states. This means that countries hoping to industrialise rapidly and modernise through greater participation in the open regional and global economic system, such as Vietnam, are forced to accept that an economically powerful China is intrinsic to the contemporary order.

The *indispensability* of an economically powerful China to regional prosperity is a new phenomenon in the post-World War Two period. This has invited speculation that this generates for China economic weapons or tools with which to seduce or else compel political and/or strategic compliance from regional countries, which might otherwise move in different directions from Beijing's main interests. Poorer countries, such as Myanmar and Cambodia, are frequently upheld as examples of smaller states deeply vulnerable to China in this context. With a GDP per capita of US\$1,775 in 2012, according to World Bank figures, and a 2012 Human Development Index ranking of 127 out of 186 countries, Vietnam appears similarly ill-equipped to resist the lure or else compulsion of Chinese economic power.

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<sup>4</sup> Figures from *The Military Balance 2013* (London: IISS 2013).

China's economic integration and importance to the region means that the economic containment of China becomes unthinkable for major regional powers, complicating Vietnam's counter-dominance plans vis-à-vis a rising China. But a Vietnamese counter-dominance mindset vis-à-vis a far more powerful China is nothing new for Hanoi. Rather, such a mindset is deeply ingrained and still strong in the current period.

Indeed, despite its relative weakness and lack of economic clout, Vietnam is admirably adroit and effective in adapting its long-standing counter-dominance strategies to the contemporary period. This paper argues that despite China's economic importance to the region and the deepening bilateral Sino-Vietnam economic relationship, Hanoi has so far managed to ensure that Beijing does not enjoy any decisive economic leverage that could be used against Vietnam in the future. Indeed, whether Vietnam's counter-dominance plans can remain successful is very much in Hanoi's own hands. A reforming political-economy that becomes increasingly attractive to regional economies and firms will enhance Vietnam's ability to execute a counter-dominant strategy. But a failing reform process means that an increasingly vulnerable Communist Party of Vietnam (CPV) may well become more reliant on Beijing for economic largesse, and perhaps even the Chinese Communist Party (CCP) for political and diplomatic advocacy and support.

## **SINO-VIETNAMESE POLITICAL AND STRATEGIC RELATIONS**

Putting aside the economic dynamics for one moment, Vietnam's relations with China are multidimensional and genuinely complex.

On the one hand, there is a strong political and ideological affinity between the ruling regimes in Hanoi and Beijing. For example, as a part of the country's 'Doi Moi' or opening up policies, Hanoi replicated the language of the CCP's economic reforms, declaring that Vietnam is building a 'socialist-oriented market economy' as part of a renewal process that will help keep the CPV in power.<sup>5</sup> Like the CCP, segments of

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<sup>5</sup> See Prime Minister Nguyen Tan Dung, "New path towards a socialist-oriented economy," *Viet Nam News*, January 22, 2012 <<http://vietnamnews.vn/economy/220033/new-path-towards-a-socialist-oriented-market-economy.html>> accessed February 14, 2014.

the CPV remain watchful that other democratic nations do not exploit the country's 'Doi Moi' policies to undermine the CPV and usher in political reforms that would dilute the power of the CPV as part of an American-led 'peaceful evolution' plot.<sup>6</sup> Vietnam regularly sends officials to China to learn from the CCP's economic and political success (in terms of remaining in power), and officials from both regimes reportedly discuss strategies for staying in power whilst the country is undertaking other reforms.<sup>7</sup> Party-to-party relations are seemingly enhanced through frequent exchanges of delegations from Central Committee Departments, administration units and experts on socialist ideology.<sup>8</sup>

Indeed, Vietnam has made discernable efforts to cultivate and maintain friendly diplomatic relations with China, and has gone out of its way to offer Beijing diplomatic concessions. For example, the CPV has generally banned any negative betrayal of China on its official websites, shut down publications critical of Beijing, and detained bloggers for publicly questioning Hanoi's softly-softly handling of the bilateral relationship with China. Prior to the 2008 Olympic Games in Beijing, Vietnamese authorities arrested members of the Falun Gong spiritual movement who are banned in Beijing and went to enormous lengths to ensure that the Beijing-bound Olympic torch relay remained free from controversy and protest.<sup>9</sup> Hanoi has also periodically suppressed domestic protests against

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<sup>6</sup> See Nga Pham, "Vietnam's new breed of dissident," *BBC*, January 21, 2010 <<http://news.bbc.co.uk/2/hi/asia-pacific/8471723.stm>>; Roger Cohen, "Peaceful Evolution Angst," *International Herald Tribune*, May 24, 2009 <[http://www.nytimes.com/2009/05/25/opinion/25iht-edcohen.html?\\_r=0](http://www.nytimes.com/2009/05/25/opinion/25iht-edcohen.html?_r=0)> both accessed January 24, 2014.

<sup>7</sup> See James Bellacqua, *The China Factor in U.S.-Vietnam Relations* (Alexandria VA: CNA March 2012) <<https://www.cna.org/sites/default/files/research/The%20China%20Factor%20in%20US%20Vietnam%20Relations%20DRM-2012-U-000184-FINAL.pdf>> accessed February 14, 2014.

<sup>8</sup> See Carlyle Thayer, "The Tyranny of Geography: Vietnamese Strategies to Contain China in the South China Sea," pg. 4.

<sup>9</sup> As above, pg. 11.

China, such as putting a stop to the series of demonstrations that occurred throughout June-July 2011<sup>10</sup> and again in January 2014.<sup>11</sup>

Beyond party-to-party diplomacy, both governments have ostensibly committed themselves to ‘long-term, stable, future-orientated, good neighbourly and all-round cooperative relations’ since 1999<sup>12</sup> – a phrase that has been repeated frequently in subsequent meetings between the two countries.<sup>13</sup> In June 2013, both countries concluded a ‘strategic partnership’ covering all economic and strategic issues,<sup>14</sup> subsequently upgraded it to a ‘strategic cooperative partnership’,<sup>15</sup> and further pledged to deepen such a partnership in October 2013.<sup>16</sup> As Vietnam-watcher Carlyle Thayer explains, the term ‘strategic partner’ is used by Hanoi to refer to countries which are particularly important to Vietnam, and with

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<sup>10</sup> Ian Timberlake, “Vietnamese hold anti-China protest after crackdown,” *AFP*, July 24, 2011 <<http://www.google.com/hostednews/afp/article/ALeqM5hQR16a wwnq6OviclCP0j2izVUUIQ?docId=CNG.64b4244314a883aef78ccc40add15420.331>> accessed February 14, 2014.

<sup>11</sup> “Hanoi cracks down on protests, 50 anti-Chinese demonstrators arrested over South China Sea,” *Herald Malaysia*, January 22, 2014 <<http://www.heraldmalaysia.com/news/Hanoi-cracks-down-on-protests,-50-anti-Chinese-demonstrators-arrested-over-South-China-Sea-18377-10-1.html>> accessed February 14, 2014.

<sup>12</sup> See “Jiang Zemin Held Talks with Le Kha Phieu,” *People’s Daily*, February 26, 1999.

<sup>13</sup> See Saw Swee-Hock, Sheng Lijun and Chin Kin Wah (eds.), *ASEAN-China Relations: Realities and Prospects* (Singapore: ISEAS 2005).

<sup>14</sup> See “China and Vietnam Sign Strategic Partnership Deal,” *CriEnglish.com*, June 20, 2013 <<http://english.cri.cn/6909/2013/06/20/3442s771140.htm>> accessed February 14, 2014.

<sup>15</sup> See Carlyle Thayer, “The U.S.-Vietnam Comprehensive Partnership: what’s in a name?,” *The Strategist*, July 31, 2013 <<http://www.aspistrategist.org.au/the-us-vietnam-comprehensive-partnership-whats-in-a-name/>> accessed February 14, 2014.

<sup>16</sup> “China, Viet Nam agree to take strategic partnership to next level,” *Viet Nam News*, October 15, 2013 <<http://vietnamnews.vn/politics-laws/246235/china-vietnam-agree-to-take-strategic-partnership-to-next-level.html>> accessed February 14, 2014.

whom Hanoi enjoys a ‘comprehensive bilateral relationship’. As Thayer contends, “Probably no major decision of any nature is made in Hanoi without taking Chinese interests and likely responses into account,” while “no other foreign state is as assertive or influential in Hanoi than China.”<sup>17</sup>

On the other hand, diplomatic outreach and amity does not necessarily imply strategic trust. The fact that Hanoi likely considers China’s interests and possible reactions to every significant Vietnamese decision occurs because Vietnam’s wariness and distrust of its much more powerful neighbour is so great. The turbulent ancient and contemporary history between the two countries means that countering potential Chinese hegemony over mainland Southeast Asia has become Vietnam’s most important long-term strategic objective. The asymmetry of power between the two countries means that while Vietnam will not accept the loss of its sovereignty or accept China as a suzerain, the consequences of sustained tension or conflict with China will be severe.

In positioning itself vis-à-vis China, Vietnam does not have any military alliance with a great power that Hanoi can rely upon. It is also facing a regional environment within which containing China in economic terms is unthinkable and probably impossible, while few countries would be willing to sign on to any strategic coalition aimed explicitly against China. Hanoi’s recent counter-dominance and hedging strategies have therefore been far more subtle and nuanced than those adopted by countries like the Philippines – the latter an American treaty ally also attempting to manage an ongoing dispute with other countries, including China, over areas of the South China Sea.

There are two pillars to Vietnam’s counter-dominance approach to China. The first is to avoid unnecessarily provoking China in a way that could escalate tensions between the two countries, especially through diplomatic relations that persistently reaffirm (in word or spirit) the 1999 formula of ‘long-term, stable, future-orientated, good neighbourly and all-round cooperative relations’ between the two countries. In doing so, Hanoi

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<sup>17</sup> Carlyle Thayer, “The Tyranny of Geography: Vietnamese Strategies to Contain China in the South China Sea,” pg. 5.

generally shies away from criticism of Chinese policies or behaviour. For example, even though its *2009 Defence White Paper* recognises that “Territorial disputes over land and sea have been more complicated, in particular those relating to sovereignty and national interests in the East Sea (South China Sea) have been on the rise,” China was not named in the section.<sup>18</sup> More generally, Hanoi avoids drawing any direct linkages between the country’s security concerns and vulnerabilities on one hand and Chinese policies and behaviour on the other. The CPV’s periodic suppression of domestic criticism of China by its own citizens should also be understood in this context as Hanoi wanting to lower diplomatic tension between the two countries.

In terms of positive bilateral diplomacy, meetings between the leaders of both countries tend to be ostensibly cordial and warm with strong emphasis on healthy party-to-party relations between the two authoritarian regimes. Communiqués and press statements offer expressions of mutual interest and affection, and avoid mention of disagreements and differences. Typical is the official press release after the October 2013 meeting between Prime Minister Nguyen Tan Dung and Chinese Premier Li Keqiang in Hanoi, which merely stated that both countries would “build a shared borderline of peace and prosperity and to work together at regional and global forums to achieve international stability.” Moreover, “On maritime issues, both... agreed to implement an agreement on the basic principles guiding the settlement of sea-related disputes”<sup>19</sup> without providing details on what these basic principles might be or when they would be adopted.

To be sure, Vietnam’s non-confrontational diplomatic approach to China conceals Hanoi’s strategic manoeuvring, much of which is squarely aimed at preventing Chinese dominance over Vietnam or at

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<sup>18</sup> See Tomotaka Shoji, “Vietnam, ASEAN, and the South China Sea: Unity or Diverseness?”, *NIDS Journal of Defense and Security*, December 13, 2012 <[http://www.nids.go.jp/english/publication/kiyo/pdf/2012/bulletin\\_e2012\\_2.pdf](http://www.nids.go.jp/english/publication/kiyo/pdf/2012/bulletin_e2012_2.pdf)> accessed February 16, 2014.

<sup>19</sup> See “China, Viet Nam agree to take strategic partnership to next level,” *Viet Nam News*.



constraining Beijing's capacity to damage the country's most important interests. This brings us to the second pillar of Vietnam's approach to managing relations and disputes with China, which is based on a counter-dominance strategy that combines a number of bilateral and multilateral approaches.

In terms of bilateralism, Hanoi has put more emphasis on expanding its 'strategic partnerships' with regional powers such as Russia, Japan, South Korea, in addition to China. It recently added prominent ASEAN member states Singapore, Thailand and Indonesia to its list of 'strategic partners'. In the keynote speech to the Shangri La Dialogue in 2013, an annual meeting of Defence Ministers held at the Shangri La Hotel in Singapore, Prime Minister Nguyen Tan Dung declared that Vietnam was putting special emphasis on building 'strategic partnerships' with all permanent members of the United Nations Security Council.<sup>20</sup>

Vietnam's improving relationship with the U.S., its former wartime enemy, is worth noting. Although still not yet official 'strategic partners', both became 'comprehensive partners' in July 2013, agreeing to deepen cooperation on security, political, economic, science and technology, cultural and people-to-people issues.<sup>21</sup> Interestingly, although Vietnam is cautious about deepening the strategic and military relationship with the U.S. for fear of Chinese disapproval, Hanoi's decision to open its Cam Ranh port to ships of all flags creates a clever and less controversial opening for American naval vessels to visit Vietnamese waters.<sup>22</sup> Such

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<sup>20</sup> "Building Strategic Trust for Peace, Cooperation and Prosperity in the Asia-Pacific Region: Nguyen Tan Dung," 2013 Keynote Address to the Shangri-La Dialogue, June 1, 2013 <<http://www.iiss.org/en/events/shangri%20la%20dialogue/archive/shangri-la-dialogue-2013-c890/opening-remarks-and-keynote-address-2f46/keynote-address-d176>> accessed February 15, 2014.

<sup>21</sup> See "Vietnam, US issue joint statement," *Viet Nam News*, July 26, 2013 <<http://english.vietnamnet.vn/fms/government/80050/vietnam--us-issue-joint-statement.html>> accessed February 15, 2014.

<sup>22</sup> See Ted Galen Carpenter, "The Looming U.S. Return to Cam Ranh Bay," *The National Interest*, June 18, 2012 <<http://nationalinterest.org/blog/the-skeptics/the-looming-us-return-cam-ranh-bay-7079>>; William Wan, "Defense Secretary Leon Panetta highlights U.S. ties to Vietnam during visit," *Washington Post*,

naval visits by American vessels under these conditions also allows Prime Minister Nguyen Tan Dung to maintain his pledge that “Vietnam will not be a military ally to any country and will not allow any country to set up military bases on Vietnamese territory” and “Vietnam will not ally itself with another country to counter another.”<sup>23</sup>

More generally, the groundwork for a significant deepening of the U.S.-Vietnam defence relationship has already been laid. For example, the annual deputy ministerial level U.S.-Vietnam Political, Security and Defence Dialogue<sup>24</sup> and U.S.-Vietnam Defence Policy Dialogue<sup>25</sup> cover the full spectrum of defence and strategic issues including maritime security. Both Dialogues are held within the framework of the Memorandum of Understanding (MOU) on Advancing Bilateral Defence Cooperation, which was signed on September 19, 2011. The MOU codified bilateral activities, which were already being carried out, and it was released to reassure Beijing that U.S.-Vietnam military collusion against China was not taking place.<sup>26</sup>

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June 4, 2012 <[http://www.washingtonpost.com/world/asia\\_pacific/defense-secretary-leon-panetta-highlights-us-ties-to-vietnam-during-visit/2012/06/03/gJQAOWcLBV\\_story.html](http://www.washingtonpost.com/world/asia_pacific/defense-secretary-leon-panetta-highlights-us-ties-to-vietnam-during-visit/2012/06/03/gJQAOWcLBV_story.html)>; Gopal Ratnam, “Cam Ranh Bay Lures Panetta Seeking Return to Vietnam Port,” *Bloomberg*, June 4, 2012 <<http://www.bloomberg.com/news/2012-06-04/cam-ranh-bay-lures-panetta-seeking-u-s-return-to-vietnam-port.html>> all accessed February 15, 2014.

<sup>23</sup> “Building Strategic Trust for Peace, Cooperation and Prosperity in the Asia-Pacific Region: Nguyen Tan Dung,” 2013 Keynote Address to the Shangri-La Dialogue.

<sup>24</sup> See “Joint Statement on Sixth Annual U.S.-Vietnam Dialogue,” U.S. Department of State, October 1, 2013 <<http://iipdigital.usembassy.gov/st/english/texttrans/2013/10/20131001283911.html#axzz2jp0cpZVI>> accessed February 16, 2014.

<sup>25</sup> “Vietnam, US Hold Defence Dialogue,” Embassy of the Socialist Republic of Vietnam in the United States of America, October 30, 2013 <<http://vietnamembassy-usa.org/news/2013/10/vietnam-us-hold-defense-dialogue>> accessed February 16, 2014.

<sup>26</sup> See Carlyle Thayer, “Vietnam Gradually Warms Up to US Military,” *The Diplomat*, November 6, 2013 <<http://thediplomat.com/2013/11/vietnam-gradually-warms-up-to-us-military/>> accessed February 16, 2014.

The reality is that declaratory statements that the U.S.-Vietnam rapprochement is not aimed at any country (i.e., China) will hardly be reassuring for Beijing.<sup>27</sup> But for Vietnam, diversifying the number of influential states with which it has strong relations with – especially in defence and strategic affairs – is largely designed to ensure that China will find it more difficult to make strategic decisions harming Vietnamese interests in the region.

Multilaterally, Vietnam has become an enthusiastic proponent of ASEAN-led institutions taking the lead in providing a setting for managing relations with much larger powers. This is evident when it comes to the South China Sea dispute with China which is currently the biggest security challenge for Vietnam and a major defining factor of Vietnam’s strategic policy. As Le Hong Hiep points out, “It’s hard to overstate the strategic importance of the South China Sea, as well as the Paracel and Spratly islands to Vietnam’s national security.”<sup>28</sup> The country is highly vulnerable to seaborne attacks and such vulnerability would be intolerably exacerbated should Vietnam cede complete control of the two archipelagos. Moreover, the revenue from the state-owned PetroVietnam – growing at about 28 per cent per annum from 2006-2010 – made up about 25 per cent of Vietnam’s GDP in 2012 and 30 per cent of the State Budget Revenues in that year.<sup>29</sup> Most of PetroVietnam’s revenue was

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<sup>27</sup> See US push in Vietnam suspicious,” *Global Times*, July 28, 2010 <<http://www.globaltimes.cn/opinion/editorial/2010-07/556629.html>>; Ely Ratner, “Rebalancing to Asia with an Insecure China,” *The Washington Quarterly* 36:2, Spring 2013 <<http://www.globaltimes.cn/opinion/editorial/2010-07/556629.html>> both accessed February 16, 2014.

<sup>28</sup> Le Hong Hiep, “Vietnam’s strategic trajectory: From internal development to external engagement,” *ASPI Strategic Insights* #59, June 2012, pg. 9 <[https://www.aspi.org.au/publications/strategic-insights-59-vietnams-strategic-trajectory-from-internal-development-to-external-engagement/SI59\\_Vietnam.pdf](https://www.aspi.org.au/publications/strategic-insights-59-vietnams-strategic-trajectory-from-internal-development-to-external-engagement/SI59_Vietnam.pdf)> accessed February 15, 2014.

<sup>29</sup> See “Message from the President and CEO,” Partnership with PetroVietnam website <<http://222.255.252.36/invest/News/Default.aspx?Mod=ViewCategory&CateID=392>> accessed February 15, 2014.

generated from its operations in the South China Sea, with a proportion of its current and future earnings to come from disputed seabeds.<sup>30</sup>

Hanoi's preference that disputes be raised (if not solved) multilaterally are obvious. As a relatively small and weak country (at least vis-à-vis China) in the region, Hanoi is keen to ensure that "Countries, both big or small" need to conduct relations "on the basis of equality and mutual respect", as Prime Minister Nguyen Tan Dung stated to the Shangri La Dialogue in 2013.<sup>31</sup> Encouraging countries such as China to be a 'responsible stakeholder', Vietnam is following the blueprint of other major Southeast Asian countries by advocating that discussion of regional disputes involving great powers are best achieved through ASEAN-led forums. When it comes to disputes in the South China, Vietnam takes the view that a binding Code of Conduct as adopted during the ASEAN Summit in Phnom Penh in 2002 is the most constructive way forward. Like other Southeast Asian claimants, Vietnam is aware that bilateral negotiations with a much larger power such as China will invariably disadvantage the smaller power. It is therefore unsurprising that Hanoi is supportive of American offers to broker an agreement between claimants.<sup>32</sup>

Moreover, although reluctant to criticise Beijing or even raise difficult issues with the Chinese bilaterally, Hanoi has shown a willingness to use its position within multilateral forums to confront these awkward issues.

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<sup>30</sup> See Jane Perlez, "Disputes Flares Over Energy in South China Sea," *New York Times*, December 4, 2012 <[http://www.nytimes.com/2012/12/05/world/asia/china-vietnam-and-india-fight-over-energy-exploration-in-south-china-sea.html?\\_r=0](http://www.nytimes.com/2012/12/05/world/asia/china-vietnam-and-india-fight-over-energy-exploration-in-south-china-sea.html?_r=0)>; Wayne Ma and James Hookway, "Vietnam Spars With China Over Oil Plans," *Wall Street Journal*, June 27, 2012 <<http://online.wsj.com/news/articles/SB10001424052702303649504577491823837421842>>; both accessed February 15, 2014.

<sup>31</sup> "Building Strategic Trust for Peace, Cooperation and Prosperity in the Asia-Pacific Region: Nguyen Tan Dung," 2013 Keynote Address to the Shangri-La Dialogue.

<sup>32</sup> See Stephanie Kleine-Ahlbrandt, "High Stakes in the South China Sea," *The Diplomat*, July 30, 2012 <<http://thediplomat.com/2012/07/high-stakes-in-the-south-china-sea/>> accessed February 16, 2014.

For example, as ASEAN Chair in 2010, Vietnam included the South China Sea issue in the agenda of various ASEAN meetings,<sup>33</sup> much to Beijing's displeasure.<sup>34</sup> This served to emphasise both the importance of the South China Sea issue to Vietnamese strategic interests and Hanoi's eagerness to use the cover of multilateralism to push these interests forward vis-à-vis China.

Most broadly, using diplomacy to minimising Chinese displeasure whilst building other bilateral and multilateral relationships to isolate or else constrain China is essentially a 'soft balancing' and hedging strategy.<sup>35</sup> The success of such an approach assumes that Vietnam has a number of low-cost balancing and hedging options and would be severely undermined by any current or future Vietnamese *dependency* on China. Whilst Sino-Vietnam strategic and security relations remain tense and distrustful, the economic relationship between the two countries is deepening.

This is a reminder that China's rise since the 1980s has primarily been an economic rather than military rise, even if it is making rapid advances in the latter. The following sections therefore look at the economic relationship between Vietnam and China – with a focus on trade and investment. These sections examine the nature and structure of the economic relationship and whether deepening Vietnamese economic

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<sup>33</sup> See Sanchita Basu Das, "ASEAN: A united front to tackle the South China Sea issue," *East Asia Forum*, May 13, 2012 <<http://www.eastasiaforum.org/2012/05/13/asean-a-united-front-to-tackle-the-south-china-sea-issue/>>; Vaudine England, "Why are South China Sea tensions rising?," *BBC*, September 3, 2010 <<http://www.bbc.co.uk/news/world-asia-pacific-11152948>> both accessed February 16, 2016.

<sup>34</sup> See Joel Rathus, "The US, ASEAN and China: Emergence of new alignment," *East Asian Forum*, August 28, 2010 <<http://www.eastasiaforum.org/2010/08/28/the-us-asean-and-china-emergence-of-new-alignment/>>; Aileen S.P. Baviera, "China: Less Charm, More Offensive," 25<sup>th</sup> Asia-Pacific Roundtable, May 30 – June 1, 2011, Kuala Lumpur <[http://www.isis.org.my/files/25APR/paper\\_ps2\\_aileen\\_baviera.pdf](http://www.isis.org.my/files/25APR/paper_ps2_aileen_baviera.pdf)> both accessed February 16, 2014.

<sup>35</sup> See Andrew Shearer, "Southeast Asia and Australia: Case Studies in Responding to China's Military Power," in Ashley J. Tellis and Travis Tanner (eds.), *Strategic Asia 2012-2013: China's Military Challenge*, October 2012.

dependency on China is likely to create problems for Hanoi's balancing and hedging strategic approach.

## **EXAMINING THE STRATEGIC IMPLICATIONS OF ECONOMIC ASYMMETRY**

The mantra used by both Vietnam and China to describe their commitment to 'long-term, stable, future-orientated, good neighbourly and all-round cooperative relations' is standard and prudent diplomacy between two states of roughly equal standing and weight. But Vietnam is a far smaller and weaker power than China, with no powerful allies unequivocally in Hanoi's corner. As Brantly Womack puts it, the challenge for Vietnam is to manage an asymmetric relationship with China in an era of economic deepening and also uncertainty between the two countries.<sup>36</sup>

The asymmetry is obvious in the difference in economic size between the two countries. When one looks at trade, for example, Vietnam's trade-to-GDP ratio from 2010-2012 was 167.2, far exceeding China's which is 53.2 over the same period.<sup>37</sup> This simply makes the point that uninterrupted trade is far more important to the Vietnamese economy than for China. Moreover, with two-way trade between both countries at US\$41.1 billion in 2012, this amounts to 18 per cent of Vietnam's total two-way trade, compared to only 1.06 per cent of China's total two-way trade.<sup>38</sup> In other words, in terms of volume, China is a far more important trading partner for Vietnam than Vietnam is for China. This suggests that any major disruption to trade between the two countries will be far more serious for the Vietnamese economy than the Chinese.

It is no wonder then that the spectre of economic retaliation by China is a genuine concern for Vietnam. Noting that Japanese exports

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<sup>36</sup> Brantly Womack, "China and Vietnam: Managing an Asymmetric Relationship in an Era of Economic Uncertainty," *Asian Politics and Policy* 2:4 2010, pp. 583-600 <<http://people.virginia.edu/~bw9c/Publications/ArticlesandChapters/2010e.pdf>> accessed February 17, 2014.

<sup>37</sup> World Trade Organisation figures.

<sup>38</sup> Based on World Trade Organisation figures and author's calculations.

to China fell 12 per cent during a period of tension between Tokyo and Beijing in mid-late 2012 when Chinese consumers boycotted Japanese goods, Vietnam's Deputy Foreign Minister Pham Quang Vinh argued that "Economic force should not be applied in the case of settlement of territorial disputes."<sup>39</sup> Indeed, as an indication of how territorial disputes with China may have longer-term economic consequences, China's trade with Japan fell 5.1 per cent in 2013, following a 3.9 per cent contraction in 2012.<sup>40</sup> Japanese direct investment in China fell 4.3 per cent in 2013.<sup>41</sup> This followed a sudden decline in Japanese direct investment into China in the month of October 2012 of about one third, as compared to monthly levels in October 2011 at the height of the Sino-Japanese spat over the Senkaku/Diaoyu Islands in 2012.<sup>42</sup>

However, the rise or fall in trade and investment volumes between two countries is only one small part of the equation. Decline in trade and/or investment between China needs to be analysed alongside the economic relationship that Vietnam has with other countries, and whether other economic relationships could significantly dampen any economic fallout vis-à-vis China. The structure and nature of trade and investment with

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<sup>39</sup> See "Vietnam says China Must Avoid Trade Weapon in Maritime Spat," *Bloomberg*, December 3, 2012 <<http://www.bloomberg.com/news/2012-12-02/vietnam-says-china-must-avoid-trade-weapon-in-maritime-disputes.html>> accessed February 17, 2014.

<sup>40</sup> See "China trade soars globally but falls 5.1% with Japan," *Japan Times*, January 10, 2014 <[http://www.japantimes.co.jp/news/2014/01/10/business/china-trade-soars-globally-but-falls-5-1-with-japan/#.UwF3K\\_mSya8](http://www.japantimes.co.jp/news/2014/01/10/business/china-trade-soars-globally-but-falls-5-1-with-japan/#.UwF3K_mSya8)> accessed February 17, 2014.

<sup>41</sup> See "Japan's 2013 direct investment in China falls 4.3% on year," Global Post, January 16, 2014 <<http://www.globalpost.com/dispatch/news/kyodo-news-international/140116/japans-2013-direct-investment-china-falls-43-year>> accessed February 17, 2014.

<sup>42</sup> Ben McLannahan and Mure Dickie, "Japanese investment in China falls sharply," *Financial Times*, November 20, 2014 <<http://www.ft.com/intl/cms/s/0/31020a3e-330e-11e2-aa83-00144feabdc0.html#axzz2tXnCXwK>> accessed February 17, 2014.

China is also important. The following sections will look more closely at these issues.

## **VIETNAM’S EXPORT-ORIENTED GROWTH MODEL AND THE STRUCTURE OF SINO-VIETNAMESE TRADE**

As previously noted, trade as a proportion of Vietnamese GDP is particularly high, a *prima facie* indicator of the importance of trade to the country’s ongoing development.

### *(a) Implications of Vietnamese reliance on exports to drive growth*

GDP is the sum of fixed investment, consumption and net exports. It is clear from **Table 1** that net-exports are emerging as an increasingly important driver of Vietnamese economic growth.

Moreover, in Vietnam’s socialist political-economy still dominated by state-owned enterprises, public debt has now reached a worrying 56.7 per cent of GDP, high for a poorly developing economy. In May 2013, the official estimate of non-performing loan levels was 4.5 per cent of outstanding loans, although the Vietnamese Central Bank admitted that the figure is likely to be closer to 8.6 per cent. Estimates by private firms such as Standard and Chartered Bank put the figure at 15-20 per cent at

**Table 1: Contributions to Vietnamese GDP by expenditure (%)**

	<b>2005</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>
<b>GDP Growth</b>	7.55	5.4	6.42	6.24	5.25	5.42
<b>Consumption</b>	72.28	77.62	75.42	75.51	73.67	n/a
<b>Fixed Investment</b>	31.86	35.39	33.92	28.03	25.31	n/a
<b>Net Exports</b>	<b>-4.14</b>	<b>-13.01</b>	<b>-9.34</b>	<b>-3.54</b>	<b>1.02</b>	<b>5.2*</b>

*Source: General Statistics Office of Vietnam; Asian Development Bank; author’s calculations*

*\* ADB estimate*



the end of 2012.<sup>43</sup> While the government sector is behind slightly less than half of all fixed investment, it is behind a majority of bad debts in the country.<sup>44</sup> This is a worryingly high figure, and constitutes the biggest systemic risk for the country's economy according to the Asian Development Bank.<sup>45</sup> To stem the danger of domestic credit expansion creating a bad-debt driven financial and fiscal crisis, fixed investment as a proportion of GDP has fallen from about 37 per cent to 27 per cent in 2012.<sup>46</sup> This is reflected in the declining importance of fixed investment as a driver of GDP growth from 2008 onwards, as shown in Table 1.

The point is that as fixed investment becomes a less potent and viable driver of economic growth, the export-oriented sectors (largely supported by foreign-direct-investment [FDI], as subsequent sections will show) will be relied upon even more to pick up the slack of driving growth and job creation. In other words, foreign demand and capital will be critical to Vietnam's future growth.

This brings us back to the Sino-Vietnam trade relationship. China has now emerged as Vietnam's largest trading partner and bilateral trade volume between the two countries has grown from US\$3.03 billion in 2001 to US\$20.82 billion in 2008 and US\$41.1 billion in 2012.<sup>47</sup> This appears to indicate China's enormous importance to Vietnam's current and future trade-driven growth and development strategy.

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<sup>43</sup> See Bich Diep, "Enterprises start to stop depending on banks: Standard and Chartered," *DTI News*, December 9, 2012 <<http://www.dtinews.vn/en/news/018001/26526/enterprises-start-to-stop-depending-on-banks--standard-chartered.html>> accessed February 18, 2014.

<sup>44</sup> See "Vietnam Banking Fix Starts With \$474 Million of Bad Debt," *Bloomberg*, August 8, 2013 <<http://www.bloomberg.com/news/2013-08-06/vietnam-bank-fix-starts-with-474-million-debt-southeast-asia.html>> accessed February 18, 2014.

<sup>45</sup> "Bad debt is the biggest challenge faced by Vietnam: ADB Chief," *AmCham Vietnam*, February 1, 2013 <<http://www.amchamvietnam.com/9410/bank-bad-debt-is-the-biggest-challenge-faced-by-vietnam-ADB-country-director-tomoyuki-kimura/>> accessed February 18, 2014.

<sup>46</sup> World Bank figures.

<sup>47</sup> World Trade Organisation figures.

However, despite its status as Vietnam’s largest trade partner, China is less important to Vietnam’s export-oriented growth strategy than two-way trade numbers might suggest. The first and most obvious clue is among Vietnam’s major export partners.

**Table 2: Vietnam’s major export partners (%)**

	<b>China</b>	<b>Japan</b>	<b>U.S.</b>	<b>E.U.</b>	<b>ASEAN</b>	<b>Rest of Asia-Pacific</b>	<b>Rest of the world</b>
<b>2002</b>	9	15	14	20	14	10	18
<b>2012</b>	11	11	17	18	15	10	18

*Source: World Bank, General Department of Vietnam Customs; General Statistics Office of Vietnam*

The exciting story for Vietnam is its booming trade with advanced economies such as the U.S. Since the *U.S.-Vietnam Bilateral Trade Agreement* was signed in 2001, America has opened its markets to Vietnam-based exporters. Two-way trade has jumped from US\$1.513 billion in 2001 to US\$29.662 billion in 2013. Importantly, exports from Vietnam to the U.S. increased from US\$1.053 billion in 2001 to US\$24.649 billion in 2013. Vietnam’s trade surplus vis-à-vis the U.S. over this period increased from US\$592.8 million in 2001 to US\$19.636 billion in 2013. In fact, Vietnam has enjoyed a trade surplus with the U.S. that has increased every year since 1997.<sup>48</sup>

Likewise, exports from Vietnam to the E.U. have increased from US\$10.85 billion in 2008 to US\$24.33 billion in 2013. The trade surplus in Vietnam’s favour has increased from US\$5.41 billion to US\$14.88 billion over the same period.

The importance of large advanced and accessible consumer economies, such as the U.S. and E.U. countries, is also confirmed by the changing make-up of Vietnamese exports.

From Table 3, we can see that while resources and agricultural products have become less important in relative terms and traditional

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<sup>48</sup> U.S. Census Bureau figures.

**Table 3: Vietnam's exports by category (%)**

	<b>Resources</b>	<b>Agriculture</b>	<b>Low cost manufacturing</b>	<b>Hi-Tech</b>	<b>Other</b>
<b>2002</b>	20	24	27	3	26
<b>2012</b>	7	12	20	22	39

*Source: General Department of Vietnam Customs*

Vietnamese low valued-added manufacturing sectors, such as garments and footwear, remain important, the most rapid growth sectors have been high-tech sectors, including electronics and computers, cell phones and accessories, and transport vehicles and parts. In 2013, driven by Samsung's US\$1.5 billion plant in the province of Bac Ninh, the high-tech category of cell phones and accessories became the top export earner for Vietnam, generating US\$21.5 billion in export revenues for the year. This represented a 70 per cent increase from the previous year and it overtook the previous leading low-cost manufacturing category of textiles and garments, which generated only US\$17.9 billion in export earnings.<sup>49</sup>

To highlight the importance of advanced economies as export markets for Vietnam, exports exceeded imports by US\$863 million for 2013, marking a second straight year of trade surpluses after a two-decade record of trade deficits. Significantly, the 2013 trade surpluses with the U.S., E.U. and Japan was US\$18.6 billion, US\$11.2 billion and US\$2.3 billion, respectively.<sup>50</sup> In the important sub-category of cell phones and accessories, the U.S and E.U. made up a combined 41.6 per cent of Vietnam's exports in 2013. This compares to China receiving a mere 2.44 per cent of Vietnamese exports in this sub-category in the same year.<sup>51</sup>

In contrast, booming two-way Sino-Vietnamese trade has been driven by the rapid increase of Chinese imports into Vietnam.

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<sup>49</sup> General Statistics Office of Vietnam figures.

<sup>50</sup> See "Cell phones topple garments as Vietnam's top export," *Thanh Nien News*, December 27, 2013 <<http://www.thanhniennews.com/index/pages/20131225-vietnam-top-export-item-cell-phones.aspx>> accessed February 18, 2014.

<sup>51</sup> General Statistics Office of Vietnam figures; author's calculations.

**Table 4: Chinese imports into Vietnam (% of total Vietnamese imports)**

	2002	2008	2009	2010	2011	2012	2013
<b>% of total imports</b>	11	20	23.9	24	23	25	28.7

Source: General Statistics Office of Vietnam; author's calculations

In fact, Vietnam's trade deficit with China has increased from US\$11.12 billion in 2008 (on two-way trade volume of US\$20.19 billion) to US\$23.7 billion in 2013 (on two-way trade volume of US\$50.21 billion).<sup>52</sup> If the mutually agreed target of US\$60 billion is reached in 2015,<sup>53</sup> Vietnam would have an estimated trade deficit of US\$28.32 billion with China, based on current ratios. This estimated trade deficit with China is over 15 per cent of GDP, based on World Bank estimates that Vietnam's GDP will reach US\$180 billion in 2015. Hence, while much of the public rhetoric, especially from the Chinese side, is about trade increases being 'win-win' for both sides,<sup>54</sup> much of the conversation within Vietnam is about ways to reduce or eliminate the trade deficit with China.<sup>55</sup>

The nature of Chinese imports into Vietnam is also noteworthy. Major categories of Chinese imports into Vietnam for 2013 are listed in Table 5A.

<sup>52</sup> General Statistics Office of Vietnam figures; author's calculations.

<sup>53</sup> See "Vietnam targets \$60b trade with China in 2015," *China Daily*, November 27, 2013 <[http://www.chinadaily.com.cn/bizchina/2013-11/27/content\\_17134581.htm](http://www.chinadaily.com.cn/bizchina/2013-11/27/content_17134581.htm)> accessed February 18, 2014.

<sup>54</sup> For example, see "Chinese VP Addresses China-Vietnam Youth Gala," *Xinhua*, November 26, 2013 <[http://news.xinhuanet.com/english/china/2013-11/26/c\\_132919984.htm](http://news.xinhuanet.com/english/china/2013-11/26/c_132919984.htm)> accessed February 19, 2014.

<sup>55</sup> See "Forum seeks ways to reduce VN-China trade deficit," *Vietnam News Agency*, November 21, 2012 <<http://en.vietnamplus.vn/Home/Forum-seeks-ways-to-reduce-VNChina-trade-deficit/201211/30041.vnplus>>; "VN eyes trade balance with China," *Viet Nam News*, May 25, 2013 <<http://vietnamnews.vn/economy/239820/vn-eyes-trade-balance-with-china.html>> both accessed February 18, 2014.

**Table 5A: Major categories of Chinese imports into Vietnam, 2013**

	<b>Materials for textiles &amp; garments</b>	<b>Iron &amp; Steel</b>	<b>Computers &amp; Electronic Products</b>	<b>Phones, parts and accessories</b>	<b>Machinery and parts</b>
<b>Import Value (US\$ billions)</b>	1.2	2.4	4.5	5.7	6.6
<b>% of Total Chinese Imports</b>	3.2	6.5	12.2	15.4	17.9

Source: General Statistics Office of Vietnam; author's calculations

Major categories of Vietnamese exports to China for 2013 are listed in Table 5B.

We can draw some conclusions from Tables 5A and 5B.

One is that Vietnam's leading exports to China tend to be low value-added products, such as natural resource and agricultural products. In contrast, Chinese imports into Vietnam are higher up the value-added chain.

Another is that the relative backwardness of Vietnam's indigenous manufacturing base means that Vietnamese manufacturing firms have become dependent on Chinese intermediary products such as machinery and parts, computer and electronic components (including for cell phones), chemicals, and iron and steel products and materials.<sup>56</sup> Indeed, an analysis of Sino-Vietnamese trade in intermediate goods from 2000-

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<sup>56</sup> Also see Ha Thi Hong Van, "Intermediate Goods Trade Between Vietnam and China," in Mitsuhiro Kagami (ed.), *Intermediate Goods Trade in East Asia: Economic Deepening Through FTAs/EPAs* (Bangkok: BRC Research Report No. 5, Bangkok Research Centre, IDE-JETRO, Bangkok, Thailand, 2011).

**Table 5B: Major categories of Vietnamese exports into China, 2013**

	<b>Rice &amp; Casava (inc., products)</b>	<b>Rubber</b>	<b>Wood and Wood Products</b>	<b>Unspun Fibres</b>	<b>Auxiliary Materials for Textiles, Garments &amp; Leather</b>	<b>Oil &amp; Coal</b>
<b>Export Value (US\$ billions)</b>	1.8	1.13	1.05	0.9	2.1	1.25
<b>% of Total Vietnamese Exports</b>	13.6	8.5	7.9	7.8	15.8	9.4

*Source: General Statistics Office of Vietnam; author's calculations*

2009 found that China enjoyed a surplus of US\$28.4 billion over this period. Some 14.06 per cent of Chinese export of intermediate goods to ASEAN went to Vietnam, while only 3.57 per cent of intermediate goods from ASEAN into China came from Vietnam.<sup>57</sup> This is consistent with trends in Chinese trade that intermediate goods have increased as share of exports from around 45-50 per cent at the beginning of this century to 55-65 per cent currently.<sup>58</sup>

<sup>57</sup> Yin Xingmin, "China's Intermediate Goods Trade with ASEAN: A Profile of Four Countries," in Mitsuhiro Kagami (ed.), *Intermediate Goods Trade in East Asia: Economic Deepening Through FTAs/EPAs* (Bangkok: BRC Research Report No. 5, Bangkok Research Centre, IDE-JETRO, Bangkok, Thailand, 2011).

<sup>58</sup> See Perry Wong, Tong Li and Song-yi Kim, "Evolving Patterns of Trade in Asia," *Milken Institute paper*, April 2013 <<http://www.milkeninstitute.org/pdf/TradeInAsia.pdf>> accessed February 19, 2014.

Such a trade structure implies that should Sino-Vietnam trade volume continue to increase, it will be extremely difficult for Vietnam to close the trade imbalance and reduce the trade deficit with China. This is due to the different stages of development between the two countries.

On the one hand, Vietnam is still a relatively undeveloped economy. While it has an advantage in terms of offering a plentiful supply of labour at a cheaper price than China, its labour force is relatively unskilled and its infrastructure and manufacturing capabilities lag those of China. Instead, Vietnam is at a similar economic stage of development as such countries as Bangladesh, Sri Lanka and the Philippines.<sup>59</sup>

On the other hand, China has moved up the manufacturing value chain to join such countries as Malaysia and Thailand.<sup>60</sup> China has significantly broadened its manufacturing production, management and technological processes, and skills base through massive foreign and indigenous investment<sup>61</sup> and the ‘learning’ that comes from doing so.<sup>62</sup> This is consistent with other surveys that show China being able to absorb a wide range of industrial technologies far better than other ‘peer’ market economies, such as Malaysia and Thailand have done over the

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<sup>59</sup> See above.

<sup>60</sup> See John Lee, *China's Economic Engagement with Southeast Asia: Thailand* (Singapore: ISEAS Trends in Southeast Asia Series #1, 2013) <[http://www.iseas.edu.sg/documents/publication/Trends\\_2013-1.pdf](http://www.iseas.edu.sg/documents/publication/Trends_2013-1.pdf)> accessed February 19, 2014; John Lee, *China's Economic Engagement with Southeast Asia: Malaysia* (Singapore: ISEAS Trends in Southeast Asia Series, forthcoming in 2014).

<sup>61</sup> See Robert Koopman, Zhi Wang, and Shang-Jin Wei, “A World Factory in Global Production Chains: Estimating Imported Value Added in Chinese Exports” *CEPR Discussion Papers* 7430, 2009 <<http://www.cepr.org/pubs/dps/DP7430#>> accessed February 18, 2014.

<sup>62</sup> See Steve D. Levitt, John A. List and Chad Syverson, “Toward an Understanding of Learning by Doing: Evidence from an Automobile Assembly Plant,” Department of Economics paper, University of Chicago, April 2013 <<http://faculty.chicagobooth.edu/chad.syverson/research/learningbydoing.pdf>> accessed February 18, 2014.

previous two decades.<sup>63</sup> At the same time, even though rising wage costs in China have lowered their price competitiveness for manufacturing,<sup>64</sup> China remains an attractive location for low-skilled manufacturing due to its superior infrastructure for manufacturing and vast indigenous supply networks. This is brought out in studies showing an increasingly impressive diversification of its export basket, covering both low-value added manufactured goods and high-tech products.<sup>65</sup>

This means that although China is now a competitor with middle-income countries, such as Malaysia and Thailand, in the manufacturing of higher-end goods, it still remains a formidable competitor for countries at the lower end of the spectrum. Lower labour costs notwithstanding, as Vietnam seeks to move up the manufacturing value chain from a low base, China will remain an attractive alternative for regional and global manufacturers. Note that such a dynamic is more to do with China's impressive advances and Vietnam's relative backwardness than in any ill-intent from Beijing's part. But the fact remains that it will be difficult

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<sup>63</sup> See Chen Fanyu, Leow Ken Wei, Ng Choon Preng, Tunesh Lingam and Vivien Wong Zi Wen, "The Effect of China's Foreign Direct Investment (FDI) on the Malaysian Economic Performance," Faculty of Business and Finance, Universiti Tunku Anbdul Rahman, March 2011 <<http://eprints.utar.edu.my/283/1/FE-2011-0806807.pdf>> accessed February 18, 2014.

<sup>64</sup> See Perry Wong, Tong Li and Song-yi Kim, "Evolving Patterns of Trade in Asia". In 1991, less developed countries such as the Philippines and Indonesia had labour costs that were, respectively, 2.9 and 2.0 times greater than China's. In 2012, the ratio of labour costs in these countries compared to China is 0.4 and 0.3 respectively. In another survey, average wages per month in Hanoi for a general worker was US\$111, compared to US\$317 in Chinese export-manufacturing areas such as Shenzhen and US\$352 in Guangzhou. See *The 22<sup>nd</sup> Comparative Survey of Investment-Related Costs in 31 Major Cities and Regions in Asia and Oceania* (Tokyo: Japan External Trade Organization April 2011) <[http://www.jetro.go.jp/en/reports/survey/pdf/2012\\_06\\_01\\_biz.pdf](http://www.jetro.go.jp/en/reports/survey/pdf/2012_06_01_biz.pdf)> accessed February 20, 2014.

<sup>65</sup> Jesus Felipe, Abdon Arnelyn, Norio Usui and Kumar Utsav, "Why China Has Succeeded – And Why It Will Continue To Do so," *Levi Economics Institute Working Paper No. 611*, August 2010 <<http://www.levyinstitute.org/publications/?docid=1292>> accessed January 16, 2014.



for Vietnam to compete with China when it comes to moving up the value-chain of export-oriented manufacturing. If so, the continuation of a dynamic in which Vietnam exports no- or lower-value added products to China and imports higher-value added products from China will likely entrench significant budget deficits for Vietnam in its trade with China well into the future. What Vietnam needs to do to change this dynamic and the implications if it succeeds in doing so will be considered later in the paper.

In summary, Vietnam's increasingly export-oriented growth model depends more on tapping into large advanced industrialised economies, such as the U.S. and E.U., than it does on the Chinese consumer market.<sup>66</sup> Note that the raft of free-trade agreements that China has signed with the region, including the ASEAN-China FTA, focuses on eliminating tariffs in China but not regulatory and other barriers to trade in finished goods and services, investment and public procurement. This means that while ASEAN+3 countries are extremely open and integrated when it comes to 'processing trade' (i.e., trade in intermediate goods,), accessing many domestic consumption sectors in countries such as China is still heavily restricted.<sup>67</sup> In this context, consumer demand in advanced economies is far more important to Vietnam's economic prospects than any such demand from China, where consumers prefer Japanese, South Korea, American and European branded consumers goods.<sup>68</sup> Even when it comes to low-value added finished goods, such as in the textiles and garments categories, consumers in advanced economies, such as the U.S.,

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<sup>66</sup> See also Ralph Paprzycki and Keiko Ito, "Investment, Production and Trade Networks as Drivers of East Asian Integration," *APEC Discussion Paper Series No. 67*, January 2010 <<http://www7.gsb.columbia.edu/apec/sites/default/files/files/discussion/67Paprzycki.pdf>> accessed February 19, 2014.

<sup>67</sup> See above; also see Razeen Sally, "China's Trade Off," *Wall Street Journal*, February 13, 2011 <<http://online.wsj.com/news/articles/SB10001424052748703843004576141352889255360>> accessed February 19, 2014.

<sup>68</sup> See David Brown, "Vietnam: Playing with fire," *Asia Sentinel*, July 7, 2013 <<http://www.asiasentinel.com/politics/vietnam-playing-with-fire/>> accessed February 19, 2014.

Japan and South Korea, are far more important to Vietnam based firms than consumers in China. As 2013 figures indicate, Vietnam exported US\$11.24 billion, US\$2.77 billion and US\$1.87 billion worth of textiles and footwear products to the U.S., Japan and South Korea, respectively, compared to just US\$710 million to China. In this sense, despite booming trade numbers, Beijing's capacity to use trade to *seduce* Hanoi in return for strategic concessions appears relatively limited. Indeed, China appears to be the primary beneficiary of growing trade between the two countries with Chinese firms importing cheap materials from Vietnam and then exporting more expensive and value-added intermediate and finished goods to Vietnamese firms.

*(b) Implications of Vietnamese 'dependency' on Chinese imports*

If China is in a relatively poor position to use trade to *seduce* Vietnam, is Vietnam's growing *dependency* on Chinese intermediate goods for its manufacturing base and capacity creating vulnerabilities for Hanoi? Such dependency also applies to such important sectors for Vietnam as textiles. In 2013, China accounted for 27 per cent of global cotton supply, over 60 per cent of fibre supply, over 50 per cent of fabric supply, and 48 per cent of spindles. Not surprisingly, China has emerged as the dominant supplier of fabric to Vietnamese firms in these sectors.<sup>69</sup>

However, one should not automatically assume that Vietnamese reliance on Chinese intermediate products implies Vietnamese vulnerability. For a start, foreign invested or owned firms produce more than half, and perhaps as much as 60 per cent of China's exports – including both intermediate goods and finished products.<sup>70</sup> This is even more pronounced in the electrical machinery, general machinery and

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<sup>69</sup> See "Vietnam sources 50% of textile raw materials from China," *Fibre2Fashion.com*, October 30, 2013 <[http://www.fibre2fashion.com/news/textile-news/newsdetails.aspx?news\\_id=154817](http://www.fibre2fashion.com/news/textile-news/newsdetails.aspx?news_id=154817)> accessed February 19, 2014.

<sup>70</sup> See Yuqing Xing, "Processing Trade, Exchange Rates and China's Bilateral Trade Balances," *GRIPS Discussion Paper 10-30*, January 2011 <[http://r-center.grips.ac.jp/gallery/docs/Process\\_Trade\\_XYQ\\_110106.pdf](http://r-center.grips.ac.jp/gallery/docs/Process_Trade_XYQ_110106.pdf)> accessed February 18, 2014.

chemical industries, which dominate trade in intermediate goods between Vietnam and China.<sup>71</sup> Such entities locate production and assembly processes in China because of the country's superior manufacturing infrastructure, access to a diverse and vertically integrated domestic supply chain, economies-of-scale and relatively low labour costs (albeit rising rapidly), in addition to tax and other incentives offered by the Chinese government.<sup>72</sup> Since foreign commercial entities and interests invest in China for purely commercial reasons, Chinese political officials would find it extremely difficult to force or persuade these foreign entities to do their political bidding, such as by issuing directives to China-based export manufacturing companies to boycott certain countries. Seeking only economic efficiencies and commercial gain, such firms or investors – such as Samsung which has large plants in both China and Vietnam – would eventually abandon basing current or future operations in China.

Moreover, the fragmentation of production and even design processes – relating to both capital- and labour-intensive stages of production – mean that it is extremely difficult for any one country or government to single out one country and impose economic costs on firms from that country. This is so given the sheer complexity of Asia's integrated manufacturing processes and the sourcing of parts, components, expertise and labour for an intermediate good that is eventually shipped from China to Vietnam. For example, manufacturing firms split production processes into various stages and relocate them to multiple partners in different countries. Parts and components are purchased from multiple suppliers, which are sometimes affiliated with that firm and at others times a third-party and 'blind' supplier from various countries. Assembly of the finished or intermediate part is outsourced to multiple partners or non-affiliated contractors from various countries. When it comes to the electronics

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<sup>71</sup> See Ralph Paprzycki and Keiko Ito, "Investment, Production and Trade Networks as Drivers of East Asian Integration," pg. 7.

<sup>72</sup> See Miaojie Yu and Wei Tian, "China's Processing Trade: a firm level analysis" in Huw McKay and Ligang Sing (eds.) *Rebalancing and Sustaining Growth in China* (Canberra: ANU Press, 2012), pp. 111-148 <<http://press.anu.edu.au/wp-content/uploads/2012/06/ch061.pdf>>; accessed February 19, 2014.

sector where transportation costs are less significant due to lower weight and bulk of these intermediate and finished products, production networks tend to be extremely diverse and complex and difficult to trace. This makes it less feasible, if not impossible, for Beijing to carry out a 'targeted' economic strike against Vietnam-based firms.

Even when it comes to the far more simple-to-target or simple-to-trace trade in commodities, generating strategic leverage through economic means is difficult. For example, there might be speculation that China could threaten to wreak significant damage on Vietnam's textile and garments industries through restricting Chinese exports of cotton and fabrics to Vietnam. To be sure, Beijing has attempted to use its supply of commodities to extract strategic and political concessions in the recent past. Previously controlling some 95 per cent of global supply, the most notable example is China's decision to scale back the imports of resources generally referred to as 'rare earth metals' to Japan following a 2010 dispute over an incident in the East China Sea.<sup>73</sup> But such actions will always trigger counter-reactions. In this case, China's move led to the opening of new rare earth mines, or previously closed mines and reprocessing operations being re-opened in the U.S., Australia, South Africa, Malaysia, Vietnam, India and Kazakhstan, subsequently reducing China's supply to the global market from 95 per cent to 86 per cent.<sup>74</sup> It also led to increased attention from the U.S. and U.K. into developing substitutes for rare earth metals.<sup>75</sup> In any event, the Chinese move caused a spike in the price of rare earth metals, triggering a market-driven

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<sup>73</sup> See John Lee, "Beware China's control of rare earth metals," *The Australian*, June 27, 2011 <<http://www.theaustralian.com.au/archive/business/beware-chinas-control-of-rare-earth-minerals/story-fn8ex0p1-1226081477270>> accessed February 19, 2014.

<sup>74</sup> See James T. Areddy, "China still dominates rare earth processing," *Market Watch*, December 5, 2013 <<http://www.marketwatch.com/story/china-still-dominates-rare-earth-processing-2013-12-05-214853845>> accessed February 19, 2014.

<sup>75</sup> See Mark Piesling, "Rare earth metals substitute could defeat Chinese stranglehold," *wired.co.uk*, July 31, 2013 <<http://www.wired.co.uk/news/archive/2013-07/31/race-for-rare-earth-minerals>> accessed February 19, 2014.

response of rendering commercially viable previously dormant rare earth mines around the world.<sup>76</sup>

More broadly, like the misleadingly named ‘rare earth’ metals (which are not actually rare but widely dispersed throughout the world), Chinese commodity and raw material exports to Vietnam, such as cotton and fabrics, are widely available from other countries. Although Vietnamese firms would suffer an immediate price hike and delay in supply as they source the banned materials from other countries, China would not be able to significantly or permanently damage the Vietnamese economy to the extent that Hanoi would offer Beijing significant strategic concessions, say, over important interests such as in the South China Sea. What is certain is that any attempt by Beijing to use such kind of trade as a weapon would cause further damage to China’s reputation and standing as an attractive destination for foreign investment and other foreign economic activity, with little if any permanent strategic gain.

Finally, any overt and sustained attempt to use trade as a strategic lever would cause significant damage to China’s standing and credentials as an economic leader in the region, which would carry adverse strategic and diplomatic consequences for Beijing. Washington is explicit that it will seek to enhance its leadership, standing and relevance in Asia through the use of ‘economic statecraft’. This includes underwriting a regional economic order based on commercial principles that are market-based and defined by the rule-of-law as fair, accessible and transparent for all countries and firms.<sup>77</sup> America’s sponsorship of an expansive Trans-Pacific Partnership agreement is explicitly linked to such ‘economic statecraft’.<sup>78</sup>

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<sup>76</sup> See Shiro Armstrong, “Rare earth metals export ban, a Chinese own goal,” *East Asia Forum*, September 19, 2011 <<http://www.eastasiaforum.org/2011/09/19/rare-earth-metals-export-ban-a-chinese-own-goal/>> accessed February 19, 2014.

<sup>77</sup> See Hillary Clinton, “Delivering on the Promise of Statecraft,” *Speech to Singapore Management University*, Singapore, November 17, 2012 <<http://www.state.gov/secretary/20092013clinton/rm/2012/11/200664.htm>> accessed February 19, 2014.

<sup>78</sup> See Maha Atal, “Hillary Clinton on Economic Statecraft,” *Forbes*, October 15, 2011 <<http://www.forbes.com/sites/mahaatal/2011/10/15/hillary-clinton-on-economic-statecraft/>> accessed February 19, 2014.

In response, China has been keen to emphasise that its growing power will be benign and its economic rise will drive further economic development and prosperity in the region.<sup>79</sup> For example, it is widely recognised that Beijing readily uses trade in general and Free Trade Agreements (FTAs) in particular to enhance its political and diplomatic standing in the region in addition to securing economic gains. While the most obvious example is Chinese economic policy towards Taiwan, which is designed to win the hearts and minds of the latter's citizens,<sup>80</sup> the political motivations behind Chinese trade policy in the region are also clear. Chinese proposals for FTAs and other trade agreements coincided with its era of 'smile diplomacy' and 'win-win' rhetoric from the late 1990s onwards.

As many commentators have noted, China's offer of a FTA with ASEAN must be understood within the context of Chinese and Japanese competition for political leadership in East Asia, alongside the desire to assure neighbours that its ascension to the WTO would not cause them economic hardship.<sup>81</sup> Coercive economic diplomacy would simply reverse recent Chinese diplomatic gains and increase the incentive for regional states to deepen their economic reliance on China's strategic competitors such as Japan and the U.S. Given the long history of enmity and distrust in Sino-Vietnamese relations and with other suitors such as

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<sup>79</sup> For example, see "Xi's trip help Asia-Pacific boost world economy," *Xinhua*, October 9, 2013 <[http://www.chinadaily.com.cn/china/2013xiapec/2013-10/09/content\\_17016063.htm](http://www.chinadaily.com.cn/china/2013xiapec/2013-10/09/content_17016063.htm)>; "China to boost economic cooperation with East Asian countries," *Xinhua*, October 8, 2013 <<http://english.peopledaily.com.cn/90883/8418021.html>> both accessed February 19, 2014.

<sup>80</sup> See John Lee, "Why Taiwan will fail," *Wall Street Journal*, March 31, 2011 <<http://online.wsj.com/article/SB10001424052748703806304576234143900899156.html>> accessed February 20, 2014.

<sup>81</sup> See John Ravenhill, "The 'new East Asian regionalism': A political domino effect," *Review of International Political Economy* 17:2, 2010, pp. 178-208; K. G. Kai, "Chinese Changing Occasional on the Development of an East Asian Free Trade Area," *Review of International Affairs* 3, 2004, pp. 584-99; D. J. Zha, "The Politics of China-ASEAN Economic Relations: Assessing the Move towards a Free Trade Area," *Asian Occasional* 26, 2002, pp. 53-82.

the U.S., E.U. countries and Japan eyeing opportunities in Vietnam, overt coercive economic diplomacy by China against Vietnam is not likely to result in significant strategic gain for China.

In terms of the sub-region, China is seeking to extend its leadership in the Asian Development Bank backed Greater Mekong Sub-region (GMS) development program<sup>82</sup> and would be reluctant to lose or jeopardize its standing within this grouping from exercising overt coercive economic diplomacy towards Vietnam. The GMS encompasses Yunnan Province, the Guangxi Zhuang Autonomous Region, Myanmar, Cambodia, Laos, Vietnam and Thailand. For China, a thriving GMS is seen as a critical component of the country's national economic strategy. In addition to the desire for a continental trading route that connects Southern China with the mainland of Southeast Asia and South Asia (bypassing maritime routes through the South China Sea and the Malacca Straits), economic integration and growing prosperity in the GMS region is seen as essential for the development of China's southern provinces.

## **FDI AND THE ROLE OF CHINESE INVESTMENT IN THE VIETNAMESE ECONOMY**

### *(a) The importance of FDI*

The growing importance of FDI to Vietnam can be seen in the increase in volume and flow of FDI into the country since implementation of 'Doi Moi' policies. The stock of FDI into the country has increased from

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<sup>82</sup> See Lim Tin Seng, "China's Active Role in the Greater Mekong Sub-region: Challenge to construct a 'win-win' relationship," *EAI Background Brief No. 397*, August 6, 2008 <[http://www.eai.nus.edu.sg/Vol1No1\\_LimTinSeng.pdf](http://www.eai.nus.edu.sg/Vol1No1_LimTinSeng.pdf)>; Xiangming Chen and Curtis Stone, "The PRC in the Greater Mekong Sub-Region: Economic and Political Implications," *ADB Institute Asia Pathways*, October 10, 2013 <<http://www.asiapathways-adbi.org/2013/10/the-prc-in-the-greater-mekong-subregion-economic-and-political-implications/>> both accessed February 19, 2014.

US\$243 million in 1990 to US\$14.74 billion in 2000 and US\$72.53 billion in 2012<sup>83</sup> – an almost three hundred-fold increase. This compares to just under a twenty-two-fold increase for the whole of Southeast Asia over this same period.<sup>84</sup>

Almost all FDI is bound for ‘greenfield’ rather than ‘brownfield’ investment, the former being a new venture in the form of constructing new operational facilities from the ground-up. This is enormously important for a developing country seeking rapid creation of employment and strengthening of national human and institutional capacity through technology and know-how transfers from more advanced economies. From 2003-2011, 99 per cent of inward FDI into Vietnam was for greenfield projects.<sup>85</sup>

Looking at the Vietnamese economy itself, the importance of foreign-direct-investment to Vietnam’s economy is also immediately obvious from Table 6.

These figures show an upward trend for the FDI sector as a proportion of GDP, while FDI is now the dominant driver of industrial production in the country. Preliminary results suggest that FDI was behind just under half of all industrial production in the country in 2013, suggesting that the upward trend for the importance of FDI is continuing.<sup>86</sup>

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<sup>83</sup> This figure is for ‘Charter Capital’ which refers to the amount of invested capital transferred into equity holdings. The actual amount of invested capital is higher since not all FDI is converted into equity shares.

<sup>84</sup> Figures from United Nations Conference on Trade and Development, *World Investment Report 2013* (Geneva: United Nations Publication 2013) <[http://unctad.org/en/publicationslibrary/wir2013\\_en.pdf](http://unctad.org/en/publicationslibrary/wir2013_en.pdf)> accessed February 24, 2014; author’s calculations.

<sup>85</sup> See Jacob Funk Kirkegaard, “Transactions: A New Look at Services Sector Foreign Direct Investment in Asia,” *ADB Working Paper Series No. 318*, November 2012 <<http://www.adb.org/sites/default/files/pub/2012/economics-wp318.pdf>> accessed February 25, 2014.

<sup>86</sup> See “Big challenge for VN’s economy in 2014,” *Vietnam Plus*, February 2, 2014 <<http://en.vietnamplus.vn/Home/Big-challenge-for-VNs-economy-in-2014/20142/45772.vnplus>> accessed February 21, 2014.



**Table 6: GDP Share and Industrial Production Share by Type of Ownership (%)**

	1995	2000	2005	2010	2012
<b>A. GDP</b>					
State Owned	40.2	38.5	38.4	33.7	32.6
Domestic Non-State	54.5	48.2	45.6	47.5	49.4
FDI Sector	6.3	13.3	16	18.7	18.1
<b>B. Industrial Production</b>					
State-Owned	50.3	34.2	25.1	18.2	16.4
Domestic Non-State	24.6	24.5	31.2	39.3	37.3
FDI Sector	25.1	41.3	43.7	42.5	46.3

Source: *Statistical Yearbook of Vietnam (1995, 2000, 2005, 2010, 2012)*

‘Industrial production’ made up 32.65 per cent of the economy in 2012 and it is Vietnam’s fastest growing overall sector. This overall sector has increased by 53.27 per cent in output size since 2005. The second largest overall sector is ‘Agriculture, forestry and fishing,’ which constituted 18 per cent of national output in 2012.<sup>87</sup>

When it comes to ‘Industrial Production’, despite Vietnam’s reputation as a resource rich country, it is clear that manufacturing is all-important, as Table 7 shows. Based on 2012 figures, manufacturing output has increased almost 83 per cent since 2005.<sup>88</sup> In 2012, over 22 per cent of all investment in the country went towards manufacturing, which was the leading sub-category (with transportation and storage a distant second at 10.5 per cent of all investment).<sup>89</sup> Taken together with Table 1, which highlights the growing importance of exports to Vietnam’s economy, it is additional evidence that export-oriented-manufacturing is becoming

<sup>87</sup> Statistical Yearbook for Vietnam figures; author’s calculations.

<sup>88</sup> Statistical Yearbook for Vietnam figures; author’s calculations.

<sup>89</sup> *Statistical Yearbook of Vietnam 2012* figures; author’s calculations.

**Table 7: Structure of Industrial Output (%)**

	<b>2005</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>
<b>Mining &amp; quarrying</b>	11.22	9.23	8.45	8.04	7.57
<b>Manufacturing</b>	82.8	85.32	86.49	87.15	87.82
<b>Electricity, gas &amp; steam supply</b>	5.52	4.92	4.47	4.28	4.12
<b>Water supply &amp; related sectors</b>	0.46	0.53	0.59	0.53	0.49

*Source: Statistical Yearbook of Vietnam 2012*

an essential driver of GDP growth for the country. This is backed up by figures showing that wholly foreign-owned enterprises employed 18.9 per cent of all Vietnamese workers in 2010, with foreign-invested joint ventures employing a further 2.5 per cent of all workers.<sup>90</sup> As the paper will shortly point out, much of the FDI into Vietnam is bound for the export-oriented sectors.

Let's look at the manufacturing sub-sectors of high importance to Vietnam.

**Table 8** is evidence of two things of note. The first is that traditional Vietnamese manufacturing categories typical for low-income countries, such as food products and textiles, have remained fairly constant in percentage of overall manufacturing. This suggests that Vietnam is not yet rapidly moving up the value-chain within the ASEAN+3 manufacturing zone. This, as the paper will discuss later, is an ongoing and serious challenge for the country. The second is that the rising sub-category in manufacturing is 'Computer, Electronic and Optical Products', which covers the manufacturing products produced by giant international firms, such as Samsung, with major plants in Vietnam. This is the export-oriented component of Vietnamese production, which is so important for the country's current account and overall economic development.

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<sup>90</sup> *Statistical Yearbook of Vietnam 2011* figures; author's calculations.

**Table 8: Major Manufacturing Products (% of Total Value of Manufacturing Products)**

	<b>2005</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>
<b>Food products</b>	21.6	21.3	20.7	20.5	21.1
<b>Textiles, Garments &amp; Leather Products</b>	14.8	13.2	13.2	13.3	13.2
<b>Chemicals &amp; Chemical Products</b>	5.7	6.5	5.3	5.1	5
<b>Rubber, Rubber &amp; Non-metallic Mineral Products</b>	11.4	12.5	11.4	11.2	11.3
<b>Computer, Electronic &amp; Optical Products</b>	4.2	4.4	4.4	6.4	7

*Source: Statistical Yearbook of Vietnam 2012*

*(b) Sources of FDI*

Let's look at where the FDI comes from.

China is clearly far from a dominant foreign investor to Vietnam. Figures for 'Charter Capital', which measure the foreign capital that has been converted into equity shares and reflected in the Charter of any firm, show that China is behind 3.26 per cent of all such capital stocks in Vietnam.<sup>91</sup>

Furthermore, the figures for stocks of FDI are generally in line with recent inflow trends. For example, in 2012, China was ranked ninth in terms of FDI inflows into Vietnam, with Chinese FDI constituting only 2.27 per cent of new and additional capital invested into the country from foreign sources. This compares to 34.21 per cent from Japan, 16.26 per cent from Taiwan, 11.85 per cent from Singapore and 7.86 per cent from South Korea.<sup>92</sup> It is true that in the first ten months of 2013, preliminary

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<sup>91</sup> Foreign Investment Agency, Vietnam figures; author's calculations.

<sup>92</sup> Foreign Investment Agency, Vietnam figures; author's calculations.

**Table 9: FDI by Country Source in Vietnam (US\$ billions)  
– Accumulation of projects still valid as of Dec 31, 2012**

	<b>Total Registered- invested Capital</b>	<b>% of Total Registered-invested Capital</b>
Japan	28.7	13.63
Taiwan	27.13	12.89
Singapore	24.88	11.82
South Korea	24.82	11.79
British Virgin Islands	15.39	7.31
Hong Kong	11.97	5.69
U.S.	10.51	4.99
Malaysia	10.2	4.85
Cayman Islands	7.51	3.57
Thailand	6.06	2.88
Netherlands	5.91	2.81
Brunei	4.8	2.28
China	4.7	2.23
Canada	4.7	2.23

*Source: Foreign Investment Agency, Vietnam; author's calculations*

estimates are that China moved into the top five investors due to a large US\$2 billion capital injection by China Southern Power Grid and China Power International Holding into a joint venture with the Electricity of Vietnam to construct a thermal power plant.<sup>93</sup> However, these large infrastructure projects tend to be relatively infrequent, while South

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<sup>93</sup> See Nguyen Thi Ngan and Zhang Jianhua, "Interview: More Chinese investment boosts China-Vietnam trade ties," *English.News.cn*, January 16, 2014 <[http://news.xinhuanet.com/english/indepth/2014-01/16/c\\_133050466.htm](http://news.xinhuanet.com/english/indepth/2014-01/16/c_133050466.htm)> accessed February 24, 2014.

Korea and Singapore still invested significantly more than China during that period.<sup>94</sup>

*(c) Sectors attracting FDI in Vietnam and the role of Chinese capital*

The sectors attracting FDI are fairly lopsided as Table 10 shows.

It is clear that much of the FDI is bound for export-oriented manufacturing firms when one considers that foreign-invested firms (overwhelmingly dominated by wholly-owned foreign firms rather than joint-ventures with domestic firms) accounted for 63.1 per cent of Vietnamese exports in 2012, rising from 56.9 per cent in 2011 to 54.2 in 2010 and 53.2 per cent in 2009.<sup>95</sup> This is further evidence that Vietnam is increasingly becoming a part of the Asia-Pacific production network and is increasingly being utilised as an alternative production base by multi-

***Table 10: Major Recipients of FDI by Sector – Accumulation of projects still valid as of Dec 31, 2012***

	<b>Number of Projects</b>	<b>Total registered-invested capital (US\$ billions)</b>	<b>% of Total Foreign Capital</b>
<b>Manufacturing &amp; Processing</b>	8072	105.939	50.32
<b>Real Estate</b>	388	49.751	23.63
<b>Tourism and Food Service</b>	331	10.606	5.04
<b>Construction</b>	936	7.489	3.56
<b>Utilities – Production</b>	87	3.942	1.87

*Source: Foreign Investment Agency, Vietnam; author's calculations*

<sup>94</sup> See “FDI in Vietnam totals 19.2 billion USD in 10 months,” *Global Times*, October 25, 2013 <<http://www.globaltimes.cn/content/820315.shtml#.UwrN5fmSya8>> accessed February 24, 2014.

<sup>95</sup> General Statistics Office of Vietnam figures; author's calculations.

national corporations (MNC) and brands from advanced economies such as Japan, South Korea and Taiwan – three of Vietnam’s four largest sources of FDI.

Samsung’s US\$1.5 billion plant in the province of Bac Ninh was mentioned earlier, which is in addition to its US\$2 billion plant in Thai Nguyen. In September 2013, LG Electronics announced its intention to spend up to US\$1.5 billion on a production complex in Hai Phong City over the next decade. Indeed, the percentage of parts and components in South Korea exports to Vietnam has increased from 7.2 per cent in 2008 to 31.4 per cent in 2012 – coinciding with Samsung’s decision to produce mobile phones in Vietnam from 2009 onwards.<sup>96</sup> Additionally, MNCs, such as Intel, Canon, and Foxconn Technology Corp, already have significant production plants in Vietnam. These global firms are predominantly behind the rise in Vietnamese exports of electronics products (such as computers, cell-phones, cameras and components), which increased almost 90 per cent in 2012 and accounts for almost one-fifth of export revenue.<sup>97</sup>

Unlike FDI and exports in the textile sectors (which mostly take the form of ‘cut, make, pack’) and sewing sectors (characterised as ‘cut, make, trim’), FDI in the electronic sectors by global giants tend to have more beneficial technological spill-overs for the local economy, even if the country’s domestic firms and general economic environment need further reforms for these domestic firms to move more rapidly up the value chain. But there is evidence that FDI by these MNCs have been beneficial for domestic firms in terms of forming stronger linkages with more advanced foreign-owned firms. This has allowed foreign-owned firms to use a greater share of locally produced intermediate inputs, and opened up new pathways for domestic firms to increase exports

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<sup>96</sup> See Jaewan Cheong, “South Korean-Vietnam FTA will open up East Asian opportunities,” *East Asia Forum*, November 7, 2013 <<http://www.eastasiaforum.org/2013/11/07/south-korea-vietnam-fta-will-open-up-east-asian-opportunities/>> accessed February 25, 2014.

<sup>97</sup> See Vu Trong Khanh, “LG Electronics Plans \$1.5 billion Vietnam Expansion,” *Wall Street Journal*, September 12, 2013 <<http://online.wsj.com/article/DN-CO-20130911-012441.html>> accessed February 25, 2014.

themselves, helping Vietnam to reduce its trade deficit with these more advanced economies.<sup>98</sup>

Indeed, a 2010 survey indicated that Japanese manufacturing companies in Vietnam procure about one quarter of their input materials from within Vietnam. This is low in comparison with Japanese firms in Thailand and Indonesia, which procure 55.6 per cent and 44.3 per cent respectively of their inputs in those countries.<sup>99</sup> But this is an improvement from a decade ago, where almost all manufacturing inputs were shipped into Vietnam to be assembled.

When it comes to China, as of the end of 2012, Chinese FDI into Vietnam constituted about 0.5 per cent of all Chinese FDI stocks globally,<sup>100</sup> indicating that Vietnam is not an investment destination that is prominent in the minds of Chinese firms. The relatively modest amount of Chinese FDI into Vietnam is mainly directed towards funding large power-engineering projects and setting up light manufacturing enterprises in Vietnam. The nature of these will be discussed in turn.

In terms of engineering projects, Chinese state-owned-enterprises (SOEs) came to prominence when it was estimated that they accounted for around 90 per cent of Engineering, Procurement and Construction (EPC) contracts for thermal power plants in recent times. As one commentator explains, in return for China offering Vietnam hundreds of millions worth of concessional loans for joint-projects to build thermal power and other plants, Vietnam was obligated to use Chinese contractors, technology, equipment and services. With such Chinese concessionary loans to Vietnam estimated at around US\$500 million at the end of 2010, much

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<sup>98</sup> See Sajid Anwar and Lan Phi Nguyen, "Foreign direct investment and trade: The case of Vietnam," *Research in International Business and Finance* 25, 2011, pp. 39-52; Sajid Anwar and Lan Phi Nguyen, "Foreign direct investment and export spillovers: Evidence from Vietnam," *International Business Review*, 20, 2011, pp. 177-93.

<sup>99</sup> See Bank of Tokyo-Mitsubishi UFJ, "Shifting FDI trends in Vietnam: Broadening Beyond Manufacturing Base to Consumer Market," *Economic Review*, 5:4, March 2010 <[http://www.bk.mufg.jp/report/ecorev2010e/Ecoreview\\_20100331.pdf](http://www.bk.mufg.jp/report/ecorev2010e/Ecoreview_20100331.pdf)> accessed February 25, 2014.

<sup>100</sup> Figures from Foreign Investment Agency, Vietnam; *World Investment Report 2013*; author's calculations.

of the Chinese FDI entering into Vietnam has gone towards setting up Chinese engineering firms and operations to build thermal power plants and other large-scale projects.<sup>101</sup> Furthermore, Chinese SOEs frequently enjoy a lower-cost advantage over rivals when bidding for contracts in these sectors due to advantages Beijing offer to Chinese SOEs. This can take the form of cheap access to capital, access to subsidised Chinese labour and other forms of state support, such as tax concessions.<sup>102</sup>

Notably, the increase of Chinese FDI into Vietnam from US\$371 million in 2011 to US\$2.3 billion in 2012 is almost wholly accounted for by an agreement between two Chinese SOEs – China Southern Power Grid and China Power International Holding – and the Electricity of Vietnam to build a thermal power plant using similar terms to those described here.<sup>103</sup>

Although the advantages afforded to Chinese SOEs in this context mean that they are often successful at winning EPC contracts in Vietnam, the performance and presence of these Chinese firms remain controversial. For example, Chinese firms are accused of cutting costs, not keeping to contractual obligations, and generally building power plants that are vastly inferior to those produced by Japanese or Western firms. Moreover, these EPC contracts performed by Chinese firms and funded by Chinese concessionary loans to Vietnam have as an effective condition a requirement that technology, equipment and services be imported from China. This only serves to worsen the bilateral trade deficit for Vietnam – especially in machinery and parts – whilst providing limited opportunity for domestic Vietnamese firms to benefit from these joint ventures with Chinese SOEs. Additionally, the winning Chinese firms for these EPC

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<sup>101</sup> See Le Hong Hiep, “The rise of Chinese Contractors in Vietnam,” *East Asia Forum*, March 14, 2013 <<http://www.eastasiaforum.org/2013/03/14/chinese-contractors-rise-in-vietnam-causes-problems-and-implications>> accessed February 25, 2014.

<sup>102</sup> See Fang Le Cooke and Zhaohong Lin, “Chinese firms in Vietnam: investment motives, institutional environment and human resource challenges,” *Asia Pacific Journal of Human Resources* 50 (2012), pp. 205-26.

<sup>103</sup> See “More Chinese investment boosts China-Vietnam trade ties,” *China Daily*, January 1, 2014 <[http://usa.chinadaily.com.cn/business/2014-01/16/content\\_17240018.htm](http://usa.chinadaily.com.cn/business/2014-01/16/content_17240018.htm)> accessed February 25, 2014.



contracts tend to import Chinese workers into Vietnam, many of whom are illegal. This is a particular source of resentment for many in Vietnam and reaffirms the widespread suspicion that Chinese largesse is only offered to Vietnam to benefit Chinese SOE firms and workers.<sup>104</sup>

With respect to manufacturing, Chinese FDI is concentrated in the low-skill, labour-intensive sectors and tends to be relatively small-scale. Surveys indicate that the Chinese parent-company is usually privately owned.<sup>105</sup> Sectors favoured by Chinese firms include textiles and garments,<sup>106</sup> as well as cheap transportation vehicles such as motorcycles.<sup>107</sup> Surveys of Chinese firms in these sectors in Vietnam suggest that they are targeting consumers in the domestic Vietnamese market, with only a few Chinese clothing brands seeking to exploit the low wages in Vietnam to produce textiles, garments and footwear for export. Even then, Chinese firms generally only use Vietnam-based operations for the final stages in textile and clothing production, such as dyeing and sewing, to avoid paying tariffs when selling to the Vietnamese domestic market.<sup>108</sup>

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<sup>104</sup> See Le Hong Hiep, “The Dominance of Chinese Engineering Contractors in Vietnam,” *ISEAS Perspective* #4 January 17, 2013 <[http://www.iseas.edu.sg/documents/publication/ISEAS%20Perspective%202013\\_4.pdf](http://www.iseas.edu.sg/documents/publication/ISEAS%20Perspective%202013_4.pdf)> accessed February 25, 2014.

<sup>105</sup> See Julia Kubny and Hinrich Voss, “The Impact of Chinese Outward Investment: Evidence from Cambodia and Vietnam,” *German Development Institute Discussion Paper* 16, 2010 <[http://www.die-gdi.de/uploads/media/DP\\_16.2010.pdf](http://www.die-gdi.de/uploads/media/DP_16.2010.pdf)> accessed February 25, 2014.

<sup>106</sup> See “Investments from China could be the double-edged knife,” *VietnamNet Bridge*, January 22, 2014 <<http://english.vietnamnet.vn/fms/business/94328/investments-from-china-could-be-the-double-edge-knife.html>> accessed February 25, 2014.

<sup>107</sup> See Julia Kubny and Hinrich Voss, “The Impact of Chinese Outward Investment: Evidence from Cambodia and Vietnam,” pg. 9.

<sup>108</sup> See “TPP and the Vietnam textile and garment story,” *VietnamNet Bridge*, July 25, 2013 <<http://english.vietnamnet.vn/fms/business/79903/tpp-and-the-vietnamese-textile---garment-story.html>>; “FDI capital begins to flow to dyeing and sewing,” *VietnamNet Bridge*, November 30, 2011 <<http://english.vietnamnet.vn/fms/business/53714/fdi-capital-begins-flowing-to-dyeing-and-textile-projects.html>> both accessed February 25, 2014.

In summary, despite geography positioning Vietnam as the leg of a capital-rich Chinese rooster, Vietnam has not become overly reliant on Chinese capital. Like other Asia-Pacific economies with relatively open investment regimes, in terms of volume, Vietnam is more dependent on private sector firms from advanced economies, such as Japan, South Korea, Singapore, Taiwan and the U.S. than they are on Chinese firms and capital. This has been a deliberate policy by Hanoi to diversify its sources of FDI in order to prevent over-reliance on China.<sup>109</sup>

Additionally, the positive spill-overs to the local economy from advanced economy firms, especially in manufacturing, operating in Vietnam tend to be more significant than those from Chinese firms operating in Vietnam. Decisions by advanced economy firms, such as Canon, Intel, Bridgestone, GE, Nike, Hewlett-Packard, IBM, Nokia, Samsung, LG and Panasonic, to invest in Vietnam tend to be portrayed as a boon and opportunity for the local economy, rather than as an economic or political threat.

Although reliance on Chinese capital and firms on thermal power plants is particularly high, the state-organised arrangement of offering Vietnam concessionary loans and export credits in return for contracts for Chinese firms, Chinese-made machinery, parts and materials, and employment of Chinese workers creates resentment within Vietnam, even if the building of much needed power plants tends to be expedited through this process. As Chairman of Vietnam's Association of Mechanical Industries, Nguyen Van Thu, put it in 2009, "The danger is that China has won most of the bids building electricity, cement and chemical plants... They eat up everything and leave nothing."<sup>110</sup>

## THE ROAD AHEAD...

Despite Vietnam's stellar economic performance in the 'Doi Moi' period, challenging times are ahead for the country. Its GDP per capita estimate

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<sup>109</sup> See Oliver Hensengerth, *Regionalism in China-Vietnam Relations: Institution Building in the Greater Mekong Subregion*, pg. 99.

<sup>110</sup> Martha Ann Overland, "In Vietnam, New Fears of a Chinese 'Invasion'," *Time*, April 16, 2009 <<http://content.time.com/time/world/article/0,8599,1891668,00.html>> accessed February 26, 2014.

for the end of 2013 is still a lowly US\$1,960,<sup>111</sup> even if the increase from a decade ago is impressive. Importantly, it is estimated that an expanding labour pool and a structural shift away from agriculture drove two-thirds of GDP growth from 2005-2010, with the remaining third coming from productivity improvements within sectors. Since growth in Vietnam's labour force will actually decline by 0.6 per cent each year over the next decade and simply shifting more and more workers from 'farm to factory' will become increasingly difficult to achieve, a surge in productivity is required to sustain high rates of GDP growth. In fact, one estimate is that Vietnam will require a 50 per cent increase in its labour productivity growth rate to sustain its recent GDP growth rates over the next decade.<sup>112</sup> The experience of East and Southeast Asia shows that such rapid gains in productivity are likely to come from the manufacturing and services sectors.

Rapid advances in manufacturing value-added and industrial capacity is likely to be driven by MNCs from advanced economies. Currently, most of the manufacturing plants established by leading MNCs use cheap Vietnamese labour for assembly. More advanced processes are either completed in other ASEAN+3 countries, or take place in Vietnam using pre-approved processes and/or embedded software, meaning that the Vietnamese component of the production chain adds relatively little value to the finished product. Local firms in countries such as China have benefitted from the investment of MNCs, such as Canon, Intel, Samsung, Fujitsu and LG Electronics, in terms of moving up the value-chain of production – increasing China's domestic industrial capabilities and

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<sup>111</sup> See Vietnam's HCM city's 2013 GDP per capita to reach 4,500 USD: forecast," *Xinhua*, December 24, 2013 <[http://news.xinhuanet.com/english/business/2013-12/24/c\\_132993011.htm](http://news.xinhuanet.com/english/business/2013-12/24/c_132993011.htm)> accessed February 26, 2014.

<sup>112</sup> See *Sustaining Vietnam's growth: The productivity challenge* (Hanoi: McKinsey Global Institute February 2012) <[http://www.mckinsey.com/~media/McKinsey/dotcom/Insights%20and%20pubs/MGI/Research/Productivity%20Competitiveness%20and%20Growth/Sustaining%20growth%20in%20Vietnam/MGI\\_Sustaining\\_growth\\_in\\_Vietnam\\_Full\\_Report.ashx](http://www.mckinsey.com/~media/McKinsey/dotcom/Insights%20and%20pubs/MGI/Research/Productivity%20Competitiveness%20and%20Growth/Sustaining%20growth%20in%20Vietnam/MGI_Sustaining_growth_in_Vietnam_Full_Report.ashx)> accessed February 26, 2014.

improving its balance of trade numbers. China's model is clearly one that Vietnam seeks to follow in this respect.

*Prima facie*, this implies that Vietnam's future prosperity will become even more dependent on advanced economy firms (and a handful of world-class Chinese firms, such as Huawei and Haier). In reality, Vietnam's ability to significantly improve its domestic industrial manufacturing capacity and productivity by leveraging off the presence of foreign MNCs depends on a number of factors.

One is the capacity of domestic firms to 'rise to the task'. In China's case, through Beijing's general insistence on joint-ventures, Chinese firms were able to hasten technology-transfer and transfer of other know-how through partnerships with foreign firms. In contrast, the vast majority of foreign firms in Vietnam are wholly-owned by the foreign-entity rather than established in a joint-venture or M&A structure. This has occurred partly because the poor capacity of many domestic firms has forced MNCs to build their own Vietnam-based subsidiaries from the ground-up. This has slowed the advance of positive spill-over effects from the presence of foreign firms and discouraged MNCs from relying on Vietnam for more advanced and value-added processes.

More broadly, Vietnamese firms (and their employees) need to 'rise to the task' and achieve rapid productivity improvements. Failure to do so will prevent Vietnam from moving up the value-chain. In terms of economic organisation and structure, even though Vietnamese SOEs accounted for only 16.4 per cent of national output in 2012, SOEs were still behind almost 38 per cent of investment in the same year. In contrast, the domestic non-state sector was behind almost 38 per cent of investment and generated 39 per cent of output, while the foreign-invested sector was behind just over 23 per cent of investment and produced over 46 per cent of national output.<sup>113</sup> With Vietnamese SOEs still enjoying privileged access to domestic capital, these figures suggest that more domestic capital needs to flow to the more efficient private sector to ensure that national savings and wealth are allocated more efficiently. Doing so would increase the economy's capacity to help support and

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<sup>113</sup> Figures from General Statistics Office of Vietnam; author's calculations.

develop indigenous firms that are better positioned to take advantage of the positive spill-over effects from the presence and activity of MNCs.

A further factor besides SOE and capital-allocation reform is institutional reform. Vietnam is a mediocre 99 out of 189 countries in the World Bank's *East of Doing Business* rankings. This compares unfavourably to middle-income ASEAN+3 countries. For example, Malaysia is 6<sup>th</sup> and Thailand is 18<sup>th</sup>.<sup>114</sup> Likewise, in Transparency International's *Corruption Perceptions Index*, Vietnam is ranked a lowly 116 out of 175 countries (below Malaysia at 53 and Thailand at 102.)<sup>115</sup> In the *International Property Rights Index*, Vietnam is 90 out of 130 countries (with Malaysia 33 and Thailand 71).<sup>116</sup> In the World Economic Forum's *Global Competitiveness Index 2013-2014*, Vietnam is ranked 70 out of 148 countries, compared to Malaysia at 24 and Thailand at 37.<sup>117</sup>

Note that these measurements and rankings essentially refer to Vietnam's 'enabling environment'<sup>118</sup> for business, which is still poor compared to many regional competitors. Improving the enabling environment means improving institutional weaknesses such as poor transparency, corruption and inadequate enforcement of contracts and other agreements. It also means reforming key sectors, such as banking and finance, so that capital flows to the most deserving, efficient and innovative firms, not just to government-preferred SOEs. Improving all these areas

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<sup>114</sup> World Bank's *Doing Business Ranking* <<http://www.doingbusiness.org/rankings>> accessed February 26, 2014.

<sup>115</sup> Transparency International's *Corruption Perception Index 2013* <<http://cpi.transparency.org/cpi2013/results/>> accessed February 26, 2014.

<sup>116</sup> *International Property Rights Index 2013* <<http://www.internationalpropertyrightsindex.org/ranking>> accessed February 26, 2014.

<sup>117</sup> World Economic Forum's *Global Competitiveness Index, 2013-2014* <[http://www3.weforum.org/docs/GCR2013-14/GCR\\_Rankings\\_2013-14.pdf](http://www3.weforum.org/docs/GCR2013-14/GCR_Rankings_2013-14.pdf)> accessed February 26, 2014.

<sup>118</sup> See Suiwah Leung, "Reforms vital for Vietnamese economy to stay on track," *East Asia Forum*, April 16, 2014 <<http://www.eastasiaforum.org/2014/04/16/reforms-vital-for-vietnamese-economy-to-stay-on-track/>> accessed April 24, 2014.

will lower transactions costs, encourage greater entrepreneurialism, and create a more predictable and stable environment as needed by individuals and firms to encourage greater entrepreneurialism and innovation.

Although wages in Vietnam are still comparatively low, Vietnam also rates poorly in surveys of firms about employee capacity throughout ASEAN+3 countries. For example, one by the Japan External Trade Organisation indicates that 51 per cent of the 808 firms surveyed had difficulty finding skilled engineers in Vietnam, compared to 53 per cent in Thailand, 38 per cent in Malaysia and the Philippines. Some 59 per cent of firms had difficulty finding adequate managers in Vietnam, compared to 43 per cent in Thailand, 36 per cent in Malaysia and 38 per cent in the Philippines.<sup>119</sup>

These lowly rankings will discourage MNCs from basing higher value-added manufacturing plants in Vietnam over these other middle-income ASEAN+3 countries. They also likely reflect Vietnam's poor capacity to emerge as a regional hub for outsourced and offshore services, such as offshore services in data, business process outsourcing, information technology, and software development. Failure to meet the above challenges would certainly mean that Vietnam will not fulfil expectations that it could become one of the leading locations in the region and the world for offshore services.<sup>120</sup>

## CONCLUSION

Although Vietnam's capacity to overcome these obstacles and weaknesses is not the concern of this paper, failure to do so is highly relevant for a number of reasons.

First, Vietnam is being looked upon as both an emerging consumer market for global firms and as an increasingly important manufacturing hub in the ASEAN+3 zone. For the moment, global firms are exploring the potential of Vietnam but still hedging their bets. MNCs are setting up

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<sup>119</sup> See *Sustaining Vietnam's growth: The productivity challenge*, pg. 32.

<sup>120</sup> As above, pg. 5.

distribution subsidiaries in Vietnam in case the domestic consumer market continues to grow. They are also setting up manufacturing plants in the country as an alternative to countries such as China. But few MNCs have decisively moved manufacturing operations to Vietnam or permanently shut-down manufacturing capacity in countries such as China.

A failing reform and enhancement in national capability process – as summarised in the previous section – would mean that Vietnam is unlikely to enjoy the economic growth rates into the future that it has achieved over the past decade. Importantly, this would also mean that advanced economy MNCs will eventually tire of Vietnam’s unfulfilled potential as the ‘next big thing’ in the contemporary economic growth story of Asia. This would deliver a considerable blow against Hanoi’s attempts at balancing against the influence of China through lessening current and future reliance on Chinese trade, investment and other forms of largesse such as concessionary loans and aid.

Second, Vietnam’s reform incapacity would have strategic and economic ramifications with respect to Hanoi’s relationship with regional powers such as Washington. For example, reform stasis would mean that Vietnam is unlikely to fulfil the conditions needed to meaningfully join and participate in the American-backed Trans-Pacific Partnership (TPP).<sup>121</sup> This would prevent the expected deepening of trade and investment ties between the U.S. and Vietnam resulting from the lowering of tariff and other economic barriers between the two countries, in addition to the harmonising of standards expected of TPP members to enhance trade

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<sup>121</sup> See Khanh Vu Duc, “Vietnam squanders reform opportunity,” *Asia Times*, December 11, 2013 <[http://www.atimes.com/atimes/Southeast\\_Asia/SEA-01-111213.html](http://www.atimes.com/atimes/Southeast_Asia/SEA-01-111213.html)>; “TPP: opportunities, challenges to Vietnam’s reform and development,” Ministry of Industry and Trade of the Socialist Republic of Vietnam release, November 15, 2013 <<http://www.moit.gov.vn/en/News/441/tpp-opportunities--challenges-to-vietnam%E2%80%99s-reform-and-development.aspx>>; Kyle Springer, “Constitutional Reform Not the Only Avenue for Economic Reforms in Vietnam,” *CSIS cogitASIA*, December 20, 2013 <<http://cogitasia.com/constitutional-reform-not-the-only-avenue-for-economic-reforms-in-vietnam/>> all accessed February 26, 2014.

and investment considerably.<sup>122</sup> If so, without the economic relationship progressing as expected, genuine progress made in the ‘Comprehensive Partnership’ between Hanoi and Washington would significantly slow.<sup>123</sup>

Third, just as successful economic reform and growing prosperity will give greater voice and momentum to those seeking the continuation and extension of ‘Doi Moi’ reform policies within the CPV, a seriously flawed reform process will offer an excuse and opening to ‘conservatives’ within the Party. They could argue that persisting with the rhetoric of reform will only dilute the hold on power of the CPV, embolden Western governments and other forces to double their efforts for effecting the ‘peaceful evolution’ of Vietnam from authoritarianism to political pluralism, and all the while achieve few lasting economic gains. If the rhetoric and practice of reform lapses, already established Party-to-Party links between the CPV and the CCP are likely to intensify as the ‘conservatives’ within both Parties fund common cause in each other’s survival at any cost to their national economy. Remember that Party-to-Party links remain strong despite the long history of animosity between the two countries due to their mutual interest in political survival. In this scenario and with foreign firms losing interest in Vietnam, future Chinese economic activity and largesse is likely to offer Beijing far more

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<sup>122</sup> See “Hoa Sen Sees Boost From TPP With Vietnam Poised as ‘Big Winner’,” *Bloomberg*, February 20, 2014 <<http://www.businessweek.com/news/2014-02-20/hoa-sen-sees-boost-from-tpp-with-vietnam-poised-as-big-winner>>; “Vietnam hopes TPP will bring more rice orders from the US,” *VietnamNet*, December 18, 2013 <<http://english.vietnamnet.vn/fms/business/91842/vietnam-hopes-tpp-will-bring-more-rice-orders-from-the-us.html>> ; Michaela D. Platzer, *U.S. Textile Manufacturing and the Trans-Pacific Partnership Negotiations* (Washington: CRS Report November 20, 2013) <<https://www.fas.org/sgp/crs/row/R42772.pdf>> all accessed February 26, 2014.

<sup>123</sup> See “U.S. Vietnam Comprehensive Partnership,” Office of the Spokesperson, U.S. Department of State Factsheet, December 16, 2013 <<http://www.state.gov/r/prs/ps/2013/218734.htm>>; Le Hong Hiep, “The US-China comprehensive partnership: key issues and implications,” *East Asia Forum*, August 6, 2013 <<http://www.eastasiaforum.org/2013/08/06/the-us-vietnam-comprehensive-partnership-key-issues-and-implications/>> both accessed February 26, 2014.



influence and leverage over Hanoi than is currently the case. It is worth remembering that Chinese economic influence works best when directed towards poor, weak and failing states with corrupt regimes and poor institutions. That need not be Vietnam's future.<sup>124</sup>

But returning to the current period, for the moment, China's current economic leverage over Vietnam should not be overstated. Vietnam's geography and history means that its wariness and distrust of China is long-standing, profound and enduring, even as Hanoi remains eager to avoid unnecessary and overt provocation of its giant neighbour. While a smaller and less powerful Vietnam has never been in a position to contain or shape China's rise, a strategic mindset of counter-dominance is deeply ingrained in Hanoi. This includes doing what it can to avoid becoming economically reliant on China, an objective that has so far been met.

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<sup>124</sup> For some possible future scenarios for reform or the lack of it, see Ha Hoang Hop, *More Change Awaits Vietnam's Political-Economy* (Singapore: ISEAS Trends in Southeast Asia Series #4, 2013) <[http://www.iseas.edu.sg/documents/publication/Trends\\_2013-4.pdf](http://www.iseas.edu.sg/documents/publication/Trends_2013-4.pdf)> accessed February 27, 2014.

TRS4/14

ISBN 978-981-4519-83-0



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