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Vietnam's Over-reliance on Exports and FDI

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EXECUTIVE SUMMARY

- Vietnam's robust economic performance over the past three decades has been heavily dependent on exports and foreign direct investment (FDI), with foreign invested companies accounting for 67.8% of Vietnam's total export turnover in 2019.
- This is seen by experts and policy makers as a vulnerability, especially given the disruptions in international trade and global supply chains caused by the COVID-19 pandemic and intensifying US-China strategic competition.
- The Vietnamese government is adopting three key measures to address this vulnerability:
    - Strengthening the production and export capabilities of domestic companies so that they can play a bigger role in the economy;
    - Encouraging private enterprises to expand into manufacturing and high-tech sectors to strengthen Vietnam's domestic industrial base; and
    - Assisting domestic companies to work with foreign-invested firms to participate in the global value chains.
- These measures are meant to mitigate the vulnerabilities generated by Vietnam's over-reliance on exports and FDI. Their adoption does not mean that Vietnam is reversing its policy of deepening international economic integration, which has been key to Vietnam's economic success so far.

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INTRODUCTION

The EU-Vietnam Free Trade Agreement (EUVFTA) that came into force on 1 August 2020 is the latest in a string of free trade agreements that Vietnam has concluded to bolster its exports. The EUVFTA's twin agreement, the EU-Vietnam Investment Protection Agreement (EVIPA), has also been ratified by Vietnam. Once it comes into force, the agreement is expected to attract more European investors into Vietnam, which has already been a favourite foreign direct investment (FDI) destination in the region.

More than 30 years since adopting market-based economic reforms in 1986, Vietnam has turned itself from an isolated pariah state and one of the least developed countries into one of the fastest-growing and most dynamic economies in the world. Vietnam's success story is unmistakably based on an extraordinary level of economic openness premised upon international trade and investment regimes like the EUVFTA and the EVIPA. But while most attention has been paid to the benefits that Vietnam had gained from its deepening international economic integration, much less has been said of the consequences of Vietnam's over-reliance on exports and FDI.

VIETNAM'S OPENNESS TO TRADE AND FDI

Although Vietnam adopted market-based economic reforms in 1986, it was not until the early 1990s that its efforts to diversify its external economic relations and pursue international economic integration started to bear fruit. The collapse of the Soviet Union and the socialist bloc in the early 1990s made it imperative for Vietnam to look for alternative export markets and capital sources. At the same time, Vietnam's market reforms in the late 1980s began to result in positive socio-economic transformations, turning the country into a promising market and investment destination by the early 1990s. Diplomatic normalizations with China in 1991 and the United States in 1995 brought an end to Vietnam's longstanding isolation and further facilitated Vietnam's international economic integration.

Against this backdrop, Vietnam achieved ASEAN membership in 1995, paving the way for it to join the ASEAN Free Trade Agreement (AFTA). In 1999, Vietnam concluded a bilateral trade agreement (BTA) with America, which came into force in December 2001. With these breakthroughs, Vietnam's exports and FDI inflows started to take off. The trend further accelerated after Vietnam successfully gained World Trade Organization (WTO) membership in 2007. After that landmark, due to deadlocks in the WTO's Doha Round and in order to further expand exports and attract more investment, Vietnam started to negotiate various free trade agreements (FTAs) with key trading partners (see Table 1).

In addition to promoting exports, Vietnam also sought to attract FDI by concluding bilateral investment agreements with more than 60 countries.[1] At the same time, some bilateral and multilateral FTAs, such as the Japan-Vietnam Economic Partnership Agreement, the Vietnam-Korea FTA, and the Comprehensive and Progressive Trans-Pacific Partnership (CPTPP), also include provisions on investment. Together with different incentive schemes and various legal and bureaucratic reforms, Vietnam has emerged as one of the most attractive destinations for foreign investors in the region.

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Table 1 - Vietnam's FTAs as of August 2020

	Agreement	Status
1.	ASEAN FTA	Effective 1 January 1993
2.	ASEAN-China FTA	Effective 20 July 2005 for Trade in Goods; 1 July 2007 for Trade in Services; 15 February 2010 for Investment; 1 July 2016 for Upgrade Protocol; 15 August 2019 for Rules of Origin provisions of the Upgrade Protocol
3.	ASEAN-Japan Comprehensive Economic Partnership	Effective 1 January 2009
4.	ASEAN-Korea FTA	Effective 1 June 2007 for Trade in Goods (except Thailand); 1 October 2009 for Trade in Goods (for Thailand); 1 May 2009 for Trade in Services; 1 September 2009 for Investment
5.	ASEAN - India FTA	Effective 1 January 2010 for Trade in Goods; 1 July 2015 for Trade in Services; 1 July 2015 for Investment
6.	Japan-Vietnam Economic Partnership Agreement	Effective 1 October 2009
7.	ASEAN-Australia-New Zealand FTA	Effective 1 January 2010
8.	Chile-Vietnam FTA	Effective 1 January 2014
9.	Vietnam-Laos Trade Agreement	Effective 3 October 2015
10.	Vietnam-Korea FTA	Effective 20 December 2015
11.	Viet Nam-Eurasian Economic Union FTA	Effective 5 October 2016
12.	Comprehensive and Progressive Trans-Pacific Partnership	Effective 30 December 2018 (14 January 2019 for Vietnam)
13.	ASEAN-Hong Kong, China Free Trade Agreement	Effective 11 June 2019
14.	Vietnam-Cuba Trade Agreement	Effective 1 April 2020
15.	Vietnam-EU FTA	Effective 1 August 2020
16.	Regional Comprehensive Economic Partnership	Under negotiation
17.	Vietnam-Israel FTA	Under negotiation
18.	Vietnam-European Free Trade Association (EFTA) FTA	Under negotiation

Source: Author's own compilation.

Figure 1 shows Vietnam's total foreign trade and accumulative foreign investment from 1990 to 2018. During this period, Vietnam's foreign trade turnover increased from US$5.16 billion to US$480.94 billion (including US$243.7 billion in exports and US$237.24 in imports). Meanwhile, the accumulative registered capital of FDI projects jumped from

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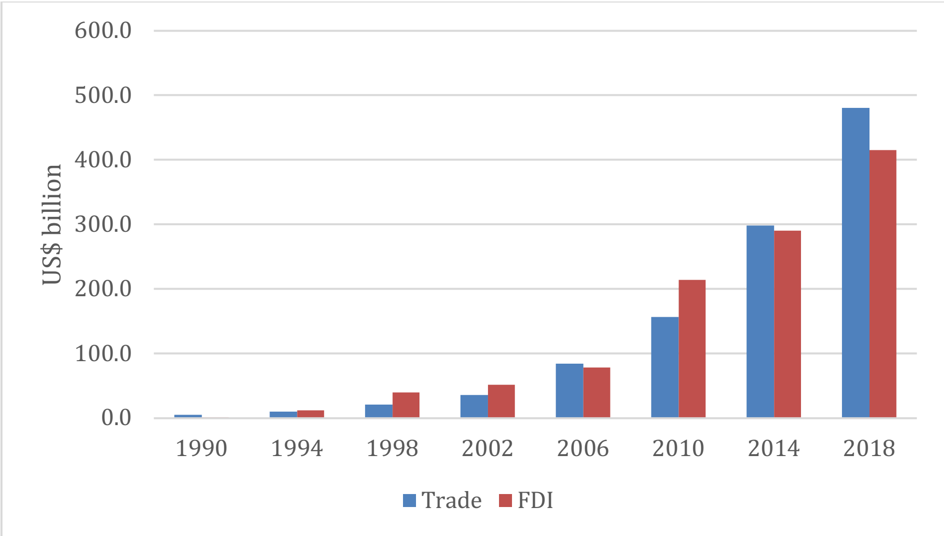
US$1.6 billion in 1990 to US$415.3 billion by the end of 2018, in which US$191 billion had been disbursed.

Figure 1 - Vietnam's total foreign trade and accumulative registered FDI (1990-2018)



Source: Author's own compilation based on data from statistical yearbooks of Vietnam.

Vietnam's impressive foreign trade and FDI performance over the past 30 years has turned the country into one of the most open economies in the world. In 2017, for example, Vietnam's trade-to-GDP ratio was 200.4%, which was the sixth highest in the world. In Asia, Vietnam was only behind Hong Kong (375.1 %) and Singapore (322.4%).[2] Similarly, FDI is also playing an important role in Vietnam's economic development. In 2019, the net annual FDI inflow of Vietnam was equivalent to 6.3% of its GDP, which was the fourth highest in Southeast Asia, after Singapore (28.3%), Cambodia (13.7%), and Laos (7.4%).[3]

Vietnam's trade openness and strong FDI performance are inter-related. As Vietnam concludes more FTAs, tariff barriers to its exports are lowered or removed, encouraging international firms to set up manufacturing facilities in the country to benefit from such preferential treatments. The surge in Chinese FDI into Vietnam after Vietnam ratified the CPTPP is a case in point. At the same time, increased foreign investment, especially in the manufacturing sector, strengthens Vietnam export performance as foreign investors bring with them more clients and generate more export products.

TWO SIDES OF THE SAME COIN

Vietnam's openness to trade and FDI originated from a combination of economic and strategic considerations. Vietnam considers international economic integration as a key measure to promote socio-economic development and to achieve the Communist Party of Vietnam's (CPV) goal of national modernization and industrialization. For example, in April 2013, the CPV Central Committee passed Resolution No. 22-NQ/TW on international integration, confirming that "proactive and active international integration is a major strategic orientation of the Party aimed to successfully implement the task of building and protecting the socialist Fatherland of Vietnam".[4] In other words, Vietnam considers foreign trade and investment as key tools to transform and upgrade its economy. Despite certain

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sceptical views from some segments within the Party,[5] this position has been maintained consistently until now. Vietnam's robust economic growth underpinned by strong export and FDI performance over the past three decades further reinforced the CPV's confidence in its trade and FDI policies.

At the same time, Vietnam also has strategic interests in pursuing open trade regimes, especially FTAs with key economies, and attracting FDI. Vietnamese strategists believe that by integrating Vietnam deeply into the global economy and strengthening economic ties with the major powers, Vietnam can align its economic interests with its partners', thereby encouraging them to protect Vietnam's interests. For example, if a rival threatens to attack Vietnam militarily, which may disrupt Vietnam's external trade and harm foreign investors' interests in the country, Vietnam will be able to mobilize international support from its trade and investment partners to pressure its rival to de-escalate tensions. During the Cold War, Vietnam lacked such a network of international economic linkages, causing Hanoi to be easily isolated and intimidated. Such considerations now incentivize Vietnam to pursue international economic integration to beef up its strategic posture.

Vietnam generally benefits from foreign trade and FDI because they create jobs and upgrade skills for the workforce, contribute to tax revenue, and boost workers' income. FDI projects also facilitate the transfer of technologies and know-how to Vietnam and create a spill-over effect through which local firms are linked up to global value chains by working with FDI firms. Many local businesses are also created by former employees of foreign companies who spin off after accumulating sufficient knowledge and experience.

Nevertheless, Vietnam's excessive reliance on exports and FDI has been seen as a potential problem for the country. While foreign invested companies accounted for only 20.3% of Vietnam's GDP, they contributed a whopping 67.8% to Vietnam's total export turnover in 2019.[6] One oft-cited example of the foreign invested sector's outsized contribution to Vietnam's economic development and export performance is Samsung. As of March 2020, Samsung was Vietnam's largest foreign investor with the accumulative investment of more than US$17 billion.[7] Samsung is also one of the biggest employers in Vietnam, with a total headcount of 110,000.[8] In 2019, Samsung's revenue in Vietnam was about USD68.3 billion, which was equal to approximately 26% of Vietnam's GDP.[9] Samsung's contribution to Vietnam's export performance is also remarkable. In 2019, the company exported US$51.3 billion worth of products from Vietnam, which accounted for 19.4% of Vietnam's export turnover in the same year.[10]

Samsung's investment in Vietnam, while a primary example of Vietnam's success in attracting FDI, also highlights the country's dependence on foreign capital and exports. A single foreign invested company contributing 19.4% to export turnover is unprecedented in Vietnam, and something rarely seen anywhere in the world. Should Samsung decide to wind up or scale back its operations in Vietnam, Vietnam's economy will suffer enormously. Last month, when an Indian news outlet reported that "Samsung may shift a major part of its smartphone production to India from Vietnam",[11] the news immediately stirred up lively debates and caused some negative reactions on social media, prompting Samsung Vietnam to quickly dismiss the report as false. The company's leaders highlighted Vietnam's importance in Samsung's global operations and stressed Samsung's long-term commitments to Vietnam.[12]

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Even if Samsung is not planning to scale back its operations in Vietnam anytime soon, Vietnam's dependence on exports and FDI makes its economic performance highly vulnerable to external shocks. Impact from the ongoing COVID-19 pandemic is a stark reminder of this vulnerability. By July 2020, although Vietnam had been able to maintain a rather stable export performance, collapsing demands from key export markets caused many foreign invested companies to downsize their production and lay off workers, especially in labour-intensive sectors such as apparel and footwear. Similarly, the wave of MNCs exiting or diversifying their production away from China over the past few years is also alarming to policy makers in Vietnam. At some point in the future, the same may also happen to Vietnam when rising labour costs make it less profitable for certain MNCs to maintain their production base in the country.

VIETNAM'S RESPONSES AND THE WAY FORWARD

Vietnam's over-reliance on exports and FDI has generated concerns among policy makers and experts. For example, Dr Nguyen Dinh Cung, former president of the Central Institute of Economic Management, found such dependence "very worrying", while Dr Vu Thanh Tu Anh, a member of the advisory board to Prime Minister Nguyen Xuan Phuc, stressed that "an economic structure that is overly dependent on external demands and export capacity of the FDI sector makes the Vietnamese economy highly vulnerable to global crises".[13] The Vietnamese government also appears to be well aware of the problem and certain remedial measures have been adopted.

Given Vietnam's extensive international economic integration and the benefits that it has gained from this process, it is undesirable for Vietnam to reverse the policy. A more feasible approach is to adopt measures to mitigate the vulnerabilities generated by such dependence. This will allow Vietnam to continue enjoying the benefits of foreign investment and the export-driven growth model, while making its economy more self-reliant and resilient to external shocks.

A key solution is to strengthen the production and export capabilities of domestic corporations so that they can play a bigger role in the economy. This is reflected in a remark by Prime Minister Nguyen Xuan Phuc at a meeting with local entrepreneurs in June 2019: "We have to build a self-reliant economy in the context of international integration. Hence, we must have a (strong) team of corporations of different types of ownership, including native private enterprises".[14]

Vietnam's FDI policy has long been criticized for favouring foreign investors at the expense of domestic ones. But recently, in dealing with domestic investors, especially private enterprises, the government has stressed four key principles: "Bình đẳng" (equality), "được bảo vệ" (being protected), "khích lệ" (being incentivized) and "trao cơ hội" (being given opportunities).[15] Legal and policy frameworks, such as the Law on Enterprise and Law on Investment, have been regularly revised and updated to ensure equality among enterprises in getting access to resources. Business environment reforms such as reducing the number of conditional businesses, cutting red tape and fighting corruption, have also been implemented to reduce cost for enterprises and to facilitate their operations. While all businesses will benefit from such reforms, the gains for domestic private enterprises will be more significant given their relatively small size and limited resources, which makes it more difficult for them to deal with business barriers.

Another measure is to encourage private enterprises to expand their businesses, especially into the manufacturing and high-tech sectors, to strengthen Vietnam's domestic industrial base. The government's support for Vingroup, Vietnam's largest private conglomerate, to expand into automobile, electronic and high-tech industries is a case in point. If successful, such "national champions" will not only boost Vietnam's GDP growth, but also generate more exports for the country. After all, foreign investors may come and go, while local businesses will always stay, and their success and long-term commitments will be the key to Vietnam's self-reliance and long-term economic prosperity.

Finally, Vietnamese businesses are also encouraged and assisted to work with foreign firms to participate in the global value chain. This is an important measure as it enables Vietnamese firms to grow up and play a bigger role in the economy in the long run. However, it is also a serious challenge as after more than 30 years, the expected spill-over effect from FDI is still limited. Samsung, for example, sources most of its components for its mobile phone factories from foreign suppliers. Among suppliers who accounted for 80% of Samsung Electronics' transaction volume and agreed to be disclosed, 28 are based in Vietnam but all of them are foreign companies.[16] To address this issue, the Vietnamese Ministry of Industry and Trade is working closely with Samsung to increase the number of qualified local suppliers for Samsung. As of 2019, the number of tier-one Vietnamese suppliers for Samsung had increased to 42. Although most of them supply rather simple products and services such as printing or packaging, some are assisted by Samsung to improve their quality control and provide more sophisticated products and services.[17] In the long run, such collaboration schemes between the Vietnamese government, major high-tech foreign investors and local enterprises may eventually enable Vietnam to make the most out of FDI inflows and to strengthen the manufacturing as well as export capabilities of Vietnamese firms.

If all the three above measures are implemented successfully, Vietnam's economy will become more resilient and its export-led, FDI-driven growth model can be claimed a success. In the meantime, however, Vietnam's over-reliance on exports and FDI remains a legitimate concern for the Vietnamese government, especially given the disruptions in international trade and the global supply chain caused by the COVID-19 pandemic and intensifying US-China strategic competition.

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