Viettonkin Consulting

Trade Intensity of FDI in Vietnam

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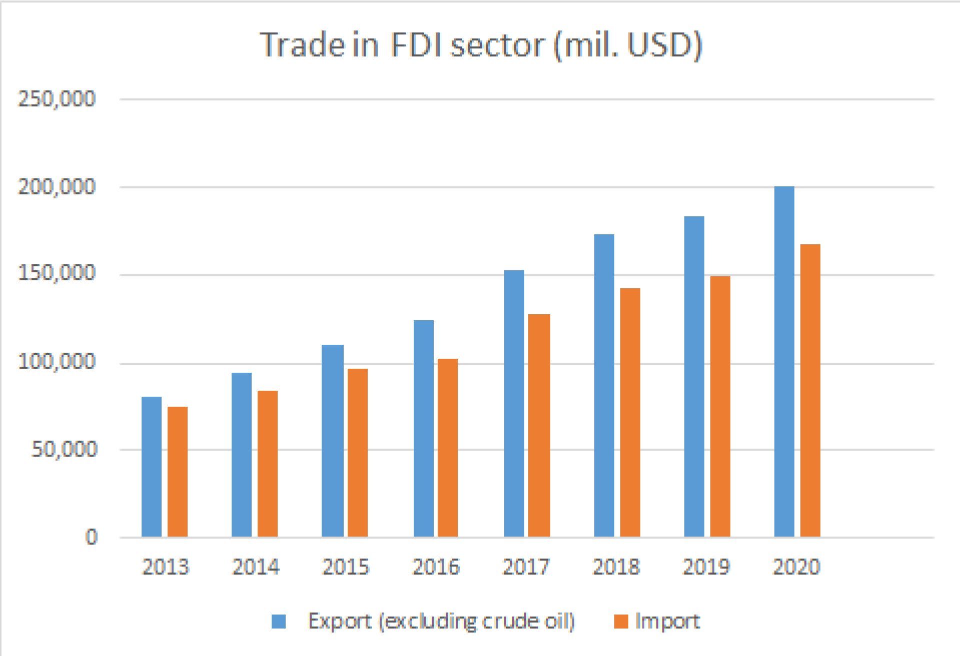
Introduction

Since the opening of the economy in 1986, Vietnam has shown non-stop development, main contributors of which are foreign direct investment (FDI) and international trade. Not only do FDI and trade make a positive impact on GDP as proved by the recent decades, the tight relationship between them is also characterized by the FDI companies. Manufacturing bases, the largest recipient of foreign direct investment in Vietnam, also plays a pivotal role in the export turnover. Although both the FDI sector and the import-export turnover witness the destruction of Covid-19 globally, Vietnam’s trade outlook remains positive, along with the progressive growth in the FDI sector. In this paper, we take a closer look at the impact of Covid-19, geographical, and industrial trends of the trade intensity of FDI in Vietnam.

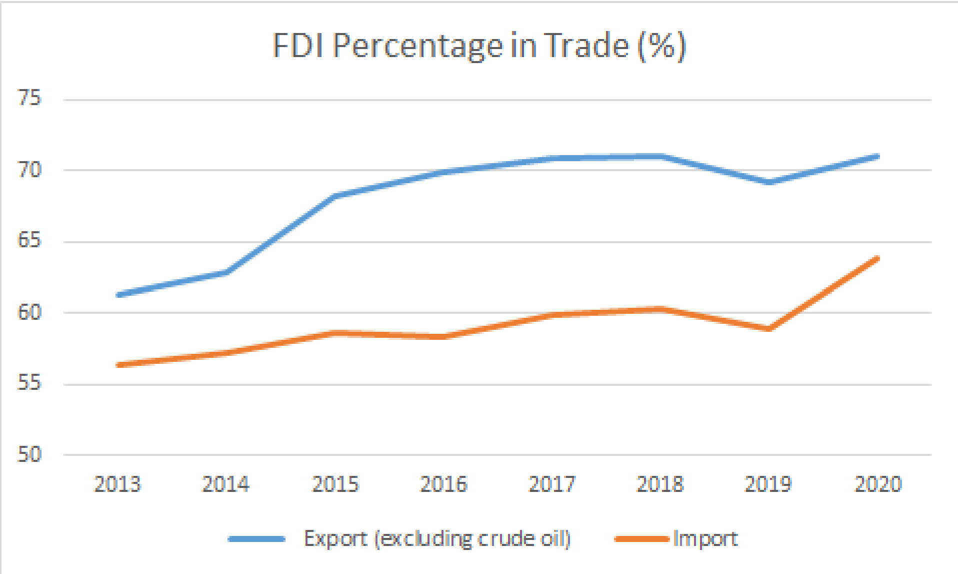
Historical Trends

The Doi Moi policy brought about free-market incentives into Vietnam in 1986, but it was not until the early 1990s when the Soviet Union collapsed that Vietnam's efforts to diversify its external economic relations and pursue international economic integration began. Foreign sources of capital as well as the international export market became the main goal for Vietnam since this very first economic expansion. Concurrently, these positive socio-economic changes pushed Vietnam forward to arrive at a promising market and an attractive investment destination. The political climate after the fall of the socialist bloc also helped to ease the strained relations between Vietnam and these countries. International economic integration, on the other hand, rose to a great extent with the normalization of diplomatic relations with China in 1991 and the United States in 1995. Became an official member of the Asia-Pacific Economic Corporation (APEC), Vietnam continued to become a member of ASEAN, which paved the way for Vietnam joining the ASEAN Free Trade

Agreement (AFTA). In 1999, the bilateral trade agreement (BTA) is signed with the United States that came into effect in December 2001. Permanent normal trade relations (PNTR) status was granted to Vietnam and encouraged participation in the World Trade Organization (WTO) since 2007. As the infant industry protection is employed, the trade outlook moved to its fast-forwarding growth phase. With these breakthroughs, exports and FDI attraction began to take off in support of trade liberalization. Attracting more investment, Vietnam began negotiating bilateral free trade agreements (FTAs) with key trading partners such as China, Japan, Korea, and Europe. This allowed expansion in the production of more high-technology goods, shifting away from solely exporting primary and low-technology manufacturing products.



Since these remarkable expansions in social, political, and economic activities in Vietnam on a global scale, the export-import turnover from foreign invested companies has been expanding with no sign of stagnation throughout the decade. A rise of 120.000 billion USD of trade in the FDI sector is observed during the course from 2013 to 2020. In 2020 especially, exports (excluding crude oil) reached 200.838 billion USD, accounting for 71.1% of export turnover. Export with crude oil, also, was estimated at 202,416 billion USD, contributing to 71.6% of the country's export turnover. Import of the foreign invested sector was 167.821 billion USD and making up for 63.8% of the country's import turnover. The first four months of 2021 continue to show an increase of more than 130% in each sector over the same period, promising a fast-moving development. Overall, the total number of exports outgrow imports, which suggests the already established contribution of FDI in Vietnam trade. The gap between the growth of exports and imports in FDI sector, therefore, is noticeable throughout the years.



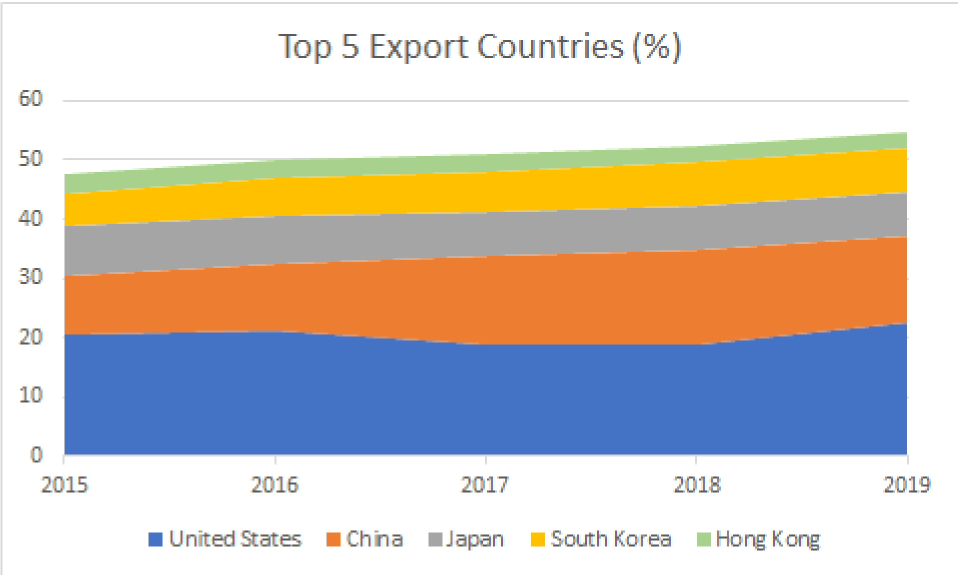
From 2013 to 2020, the contribution of FDI to trade increased from roughly 60% to 70%. Vietnam remained as an attractive destination for FDI due to its open trade network. However, this also makes Vietnam vulnerable to slowing global demand, which may affect Vietnam's exporting and importing industry. Therefore, a slight decline was observed in 2019. Despite the fall, FDI's contribution to the trade sector recovered with a steep rise in 2020. Vietnam generally benefits from foreign trade and FDI since they create jobs and enhance the skills of the workforce, contribute to tax revenue and increase workers' incomes. FDI projects also facilitate the transfer of technology and production techniques to Vietnam, creating a spillover effect through which domestic enterprises are connected to the entire value of the information chain. Increased foreign investment, especially in the manufacturing sector, helps strengthen Vietnam's export record as foreign investors bring in more customers and create more export products.

Covid Impacts

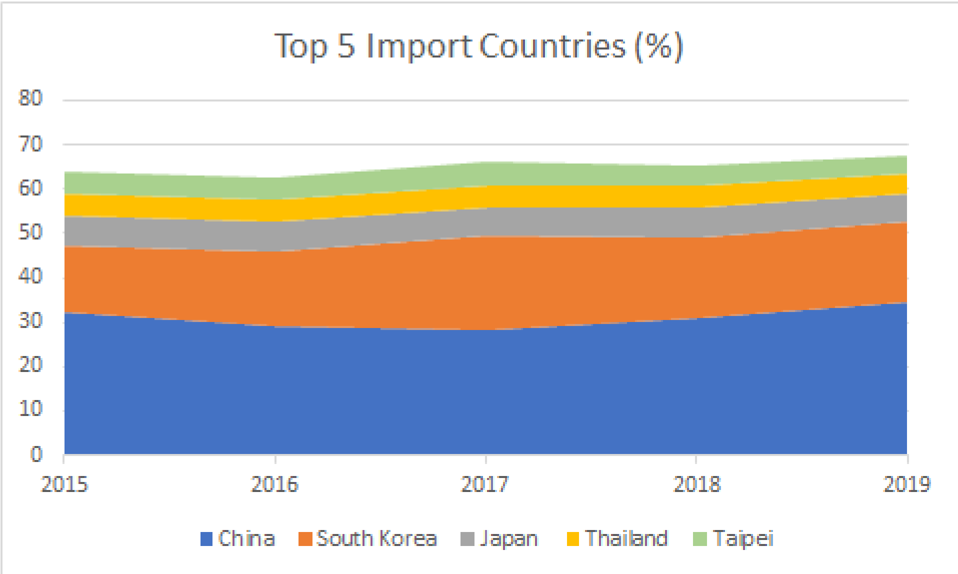
The impact of Covid-19 on global trade outlook is tremendous. From initial measurements to the continuous lockdown in more than 30 countries, half of the world population returns to unemployment status. Foreign economies falling into a stagnation is the inevitable result. Losses in income delays demand in exported and imported goods. The supply side bears the more severe burden of Covid-19 with direct influence on the global supply chain. Factories constraints and labor shortages limit goods production. International flight cancellation induces lagged transit times and leads to additive inventories. Restriction in travel routes, as well as in-person trade, also deals a great blow to the pessimistic global situation. According to WTO, the volume of world merchandise trade fell 5.3% and the travel services were down by a devastating amount of 63% in 2020.

Yet, Covid-19 brings about a new wave of opportunity for Vietnam, especially serving as an open gate for the acceleration of trade and FDI. In total, Vietnam’s export-import turnover rose to US$543 billion in 2020, witnessing a 5 percent annual rise. With an estimated export value of US$281 billion, exports maintained to be the major contributor to this unexpected increase. The trade intensity of FDI, as a consequence of the positive trade outlook, also rose to a great amount. FDI contributed 63 percent to the import turnover, as well as a 72 percent endowment to the total export. Foreign companies, therefore, set the stage for Vietnam’s development through the form of export and import services. To explain this positive change despite the global stagnant economy, manufacturing bases in China were gradually moved to Vietnam due to Covid-19 concerns. This substitution in the production process and the overall supply chain were also fostered by strict measurement in Vietnam to cope with the pandemic from the beginning, allowing foreign firms to remain hopeful in Vietnam's future state. The soaring demand in Covid-19 related products stimulated the trend in diversifying production outside of China over the past few years. Vietnamese businesses, especially labor-intensive ones, need to identify a strategy to join globalization in a period of many changes in the world economy to be able to take advantage of these opportunities.

Geographical Trends

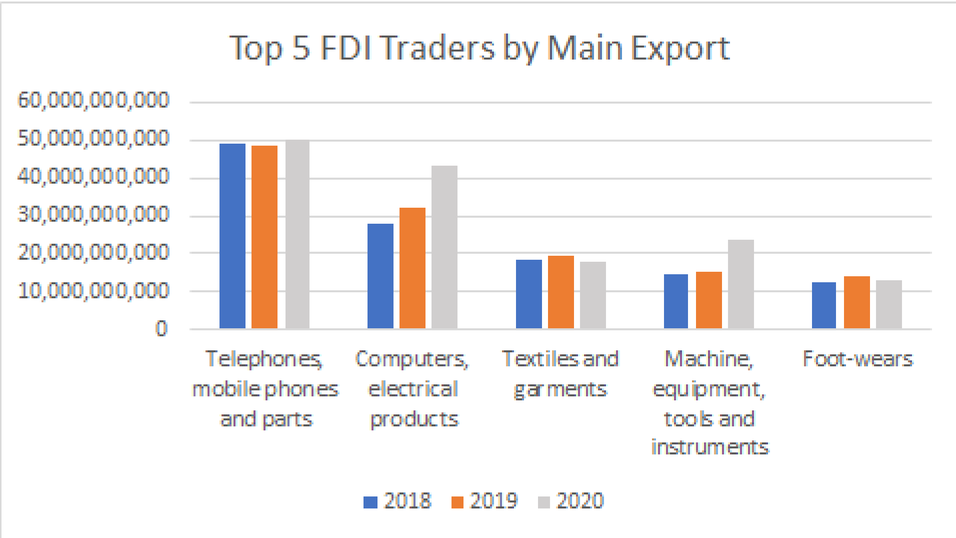


In the course of recent five years, the United States, China, Japan, South Korea, and Hong Kong remain the top exporting destinations of Vietnam, accounting for a growing 60% of the total export. Following China, Vietnam takes the second place in the share of US imports. With a contribution of 5.5%, Vietnam's share has grown a significant 65% in these past five years. Over the same period, export turnover in Vietnam accounted for by the US also rose to 72 percent. The long term relationship between Vietnam and the US was tightened by the impact of the recent US-China trade war. Together with the impact of the Covid-19, the trade war drove foreign investment to a lower cost labor and less complex environment issue country - Vietnam. However, the main FDI resources in Vietnam do not originate from the United States. China, Japan, and Korea all ranked in the top five investors in Vietnam and top exporting locations. Geographic distance reduces the maximum cost to transport goods among Vietnam and these countries. With the strategic position in Southeast Asia, Vietnam attracts foreign investment and exporting ASEAN markets. Moreover, compared to other ASEAN members, Vietnam maintains a low labor cost and sourcing, only half of those in China and roughly 40% in Thailand and the Philippines. The young, skilled, inexpensive, and increasing workers foster Vietnam's growing export turnover.

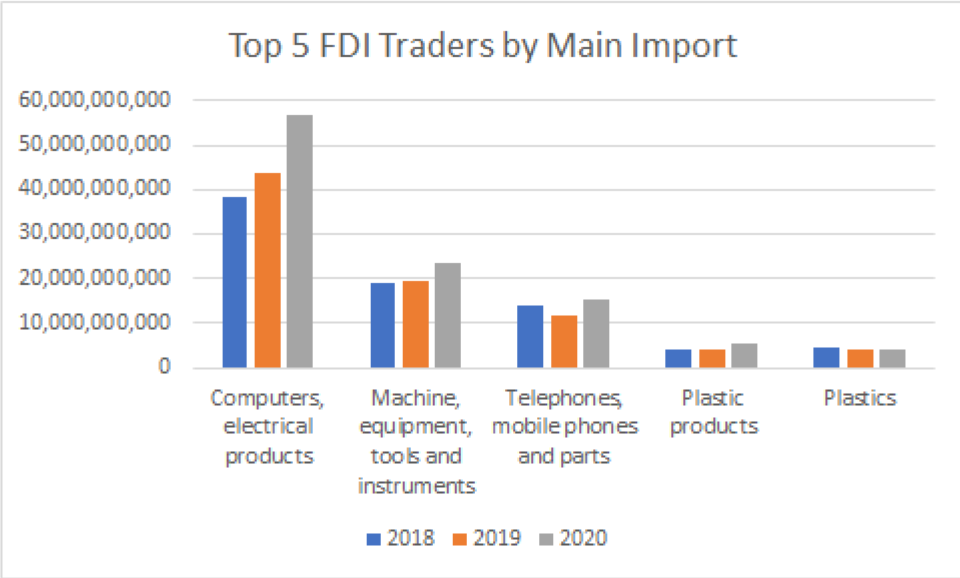


The main contributors to Vietnam's import turnover are China, South Korea, Japan, Thailand, and Taipei. According to economist Pham Chi Lan, Chinese companies are using Vietnam as an intermediary market to export its products to other countries. She further supported her argument that there was no major FDI project from mainland China recorded in the last 10 months. Therefore, Vietnam should be aware of its "Made in Vietnam" label being used by Chinese firms to distribute their products globally. The global boycott of Chinese products is indeed climbing, as well as the dependence of Vietnam on sourcing materials for manufacturing, places China in the first place as an importing country in Vietnam. Former head of the Institute of World Economics and Politics in Hanoi, Vo Dai Luoc, said that in terms of FDI, Vietnam needs to filter out Chinese projects that mostly harness manual labor work and bring in outdated technology, which could affect the environment adversely. The transportation cost also explains the rise of imports from China, as well as South Korea, Japan, Thailand, and Taipei. Manufacturing bases located in Vietnam through these countries' FDI also become a pivotal location for imported goods. Despite the high fixed costs, multinational firms replicate their production process and break up their production chain in foreign countries to lower their production costs.

Industry Trends



As trade intensity of FDI gradually increases over the last decade, the number of FDI traders by main export shows a similar trend. The export turnover of phones and components of FDI enterprises reached 50.0 billion USD in 2020, up 3.2% over the previous year and accounted for a remarable 97.75% of the total export turnover of this group. This is mainly due to FDI enterprises, in which investment projects of Samsung in Bac Ninh and Thai Nguyen contribute the most. Computers and electronic components contributed over 43.15 billion USD, up 34.7% compared to 2019 and accounting for 96.8 % of total export turnover of this product in Vietnam. The export of machinery, equipment and spare parts of FDI enterprises reached 23.7 billion USD, up 56.4% compared to 2019 and accounted for 87.3% of the whole industry. Textile and foot-wears, however, show a slight 10% decrease in its export turnover. The impact of FDI is immense on the supply chain that promotes the export-oriented activity in Vietnam.



Computers, electronic goods and components give rise to the import turnover of FDI enterprises with the most notable amount of USD 55.0 billion, up 26.2% compared to 2019 and accounting for 86% of the total import turnover. The second most imported products are machinery, equipment, tools and spare parts, whose FDI enterprises in 2020 reached 23.6 billion USD, up 22.9% compared to 2019. Phones and components's import turnover of FDI enterprises also rose to 14.4 billion USD, up 22.0% compared to 2019 and accounted for 86.6% of total import turnover. FDI enterprises imported more than 2.4 million tons of plastic products, worth nearly 4.3 billion USD, down 0.5% in turnover and accounting for 51.1% of total import turnover of plastic materials of Vietnam. Plastics, overall, also are imported by the FDI enterprises accounting for 73.8% of total import turnover, equivalent to 5.4 billion USD, up 26.7% compared to 2019. FDI traders arrive in Vietnam for its prosperous raw material as well as diverse labor skills. The trend in the imported and exported goods, in general, can also be seen in the rise of intra industry trade between Vietnam and the top export-import partner.

Legal Framework

As free trade agreements lay the foundation for the opening market of Vietnam to integrate in the global economy, it is of great importance to take a closer look into the influence of recent and future regulations on Vietnam's trade intensity of FDI. Most recently, the EU-Vietnam Free Trade Agreement (EUVFTA) was approved and went into effect in August 2020. Along with EUVFTA, Vietnam also signed the Vietnam-EU Judicial Protection Agreement (EVIPA). The implementation of these new agreements will create a favorable environment for Vietnam to promote investment attraction in a number of areas where the EU has potential and strengths due to the rise in the degree of EU investment liberalization in Vietnam. Investment terms continue to be used in a host of bilateral and multilateral FTAs, including the Vietnam-Korea FTA and the Comprehensive and Progressive Agreement for Trans-Pacific Partnership. Vietnam has become one of the most appealing destinations for international trade in the country, thanks to a variety of policy goals and numerous legal and administrative reforms. More effective policies are also implemented by the government. From changing the financial sector to enhancing the workforce's quality, the participation of FDI in Vietnam's trade becomes much more competitive.

Future Outlook

Vietnam's international trade in foreign invested sector is moving fast along its learning curve, especially during the Covid-19. For labor-intensive firms, the policy of increasing productivity by exporting needs to be more effective. Improvement in labor productivity by means of calling for FDI from foreign enterprises will bring about better results. Large scale businesses might be underusing their sources that not only results in production's ineffeciency, but also the overall import-export turnover. Downsizing and other measurements need to be implemented to make large exporters more advantageous. Along with the rise in the trade intensity of FDI, the issue of labor inequality also emerges. Technological change within sectors will result in new and better machines displacing unskilled workers. Increasing automation also takes part in widening the gap in income distribution pattern.

Prime Minister Nguyen Xuan Phuc emphasized that "The economic structure depends heavily on external demand and the export capacity of the FDI sector, making Vietnam's economy vulnerable to the global crisis". After coping with the pandemic, foreign countries are also starting to recover, posing an imminent threat to the continuous growth of Vietnam. Adaptability in technology and business strategies must be prioritized to deal with the ever-changing condition. There will also be a rise in localization travel and trade restrictions. In *Vietnam's Over-reliance on Exports and FDI,* Le indicates that the shift in production from China to Vietnam can also be reversed after the course of the pandemic due to rising labor costs as well as the demand to diversify products. The major amount of export-import turnover made up by the FDI sector will inflict a heavy damage to Vietnam once foreign firms cease to take part in the local supply chain. Therefore, Vietnam needs to invest more in its local production.