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October 2020

Working Paper No. 2020/22

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Prema-chandra Athukorala* and Nguyen Trung Kien

Abstract: This chapter examines emerging patterns of foreign direct investment and trade in the Vietnamese economy in the context of its transition from central planning to a market economy over the past three decades. Following a stage-setting overview of policy reforms, it analyses the role of foreign direct investment in outward orientation of the manufacturing sector by linking it to the rapidly-evolving East-Asia-centred global production networks. The indications are specialisation in labour intensive talks within global production networks of electronics and electrical goods is going to play the dominant role in expanding manufacturing exports from Vietnam in years to come. The analysis brings into sharp relief the pivotal role of concurrent liberalisation of foreign investment and trade policy regimes, albeit in a constrained fashion, in the process of economic transition in this era of economic globalisation.

JEL Classification: F13, F23, O14

Keywords: Vietnam, economic transition, foreign direct investment, export performance

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Forthcoming in Jonathan London (ed), *Routledge Handbook of Contemporary Vietnam*, London: Routledge

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INTRODUCTION

Opening the economy to foreign direct investment and trade has been central to Vietnam's gradual transition over the past three decades from a Soviet-style centrally-planned economy to a market economy. From a hesitant start in the late 1980s, Vietnam has gone a long way in relaxing restrictions on foreign direct investment (FDI), particularly in export-oriented projects, and equalizing policies governing local and foreign investors, even though the overall incentive structure is still skewed in favour of State- owned enterprises (SOEs) in some key industries. Trade policy reforms have dismantled numerous quantitative import restrictions and significantly reduced tariffs. Thanks to these reforms, the Vietnamese economy has become outward oriented, with FDI and trade playing a pivotal role in growth and structural transformation of the economy. Foreign invested enterprises (FIEs)[i] have become instrumental in linking the manufacturing sector to the rapidly evolving East-Asia-centred global production networks.

The purpose of this chapter is to survey the development of foreign investment and trade regimes and examine emerging patterns of foreign capital inflows and trade in the economy. A key theme running through the analysis is the role of FDI in outward orientation of the manufacturing sector and linking it to global production networks (GPNs) . The chapter begins with an overview of foreign investment and trade policy reform. The next three sections examine in turn changing patterns of foreign direct investment, export performance, the role of foreign direct investment in the expansion of manufacturing exports and the emerging patterns of Vietnam's engagement within East-Asia centred GPNs. Key findings and suggestions for further research are summarised in the final section.

POLICY CONTEXT

During the era of central planning from the mid-1950s, the economy of North Vietnam was characterised by state ownership of industry, collectivization of agriculture and cottage industries, and state monopoly on trade. After the political reunification of the country in 1975, replacing the market by plan in the south presented formidable challenges. Effort to collectivize agriculture in the South were largely unsuccessful mainly because of resistance of farmers. Nationalisation of industry and commerce had a disastrous impact on industrial output and overall economic activity. By the mind-1980s, the socialist economy of Vietnam was at the brink of disaster, with rampant inflation and a chronic balance of payments situation. Economic difficulties were compounded by the failure of promised foreign assistance from the Western countries and Chia to materialise, following Vietnam's invasion of Cambodia in 1978, and dwindling of Soviet aid. Worsening economic conditions gave the upper hand within the communist party to those favoured changing the course and transition to a market economy (Dollar and Ljunggren, 1997; Riedel and Comer, 1997).

The government of Vietnam announced its decision to make a transition from planned economy to a market economy, albeit one with a 'socialist orientation', at the Sixth Communist Party Congress held in December 1986. The reform process, which was introduced under the slogan of *doi moi* (*renovation*) and implemented gradually during ensuing three decades, set the stage for the development of a market economy characterised by a 'fuzzy' mix of state and private ownership.. The key elements of the reforms included permitting foreign direct investment (FDI) with a guarantee against expropriation and encouraging with tax holidays and permitting full repatriation of profits, eliminating government monopoly on trade, and removal of import quotas and licencing to achieve a tariff-based foreign trade regime.

FDI Policy

The Vietnamese National Assembly passed the first law on FDI in Vietnam in December 1987. It specified three modes of foreign investor participation: (i) business cooperation contracts (BCCs), (ii) joint-ventures and (iii) fully foreign-owned ventures. Foreign participation in the fields of oil exploration and communication was strictly limited to BCCs. In some key sectors such as transportation, port construction, airport terminals, forestry plantation, tourism, and cultural activities, joint venture with domestic state-owned enterprises (SOEs) was specified as the sole mode of foreign entry. Fully foreign-

owned ventures in other sectors were permitted only under special considerations according to policy priorities of domestic industrial development. The duration of foreign ownership of approved projects was limited to a maximum of 20 years, unless under exceptional circumstances. The incentives offered to foreign investors included exemption from corporate income tax for a period of two years commencing from the first profit-making year, followed by a preferential corporate tax rate between 15% to 25% in priority sectors (as against the standard rate of 32%). Overseas remittance by FIEs for the provision of technology services, repayment of loans, and repatriation of after tax profit were freely allowed (Tran, 2007; Mallon, 2004; Riedel and Comer, 2007).

In 1991, legislation was passed to permit setting up of export processing zones (EPZ), as focal points of meeting infrastructure development for export-oriented FDI and providing FIEs with duty free access to imported inputs. The duration of foreign participation in approved projects was extended from 20 years to 50 years and 70 years in special cases in 1992. A new law enacted in 1996 permitted private enterprises to enter into joint ventures with foreign investors and streamlined procedures for the approval of investment projects. The tax holiday for investment in priority sectors was extended up to 8 years, with a beyond-tax holiday income tax rate of 10%.

The initial significant opening of the economy to foreign investment led to a growing resentment against FDI within certain circles of the Communist Party, resulting in adoption of a number of restrictive policy measures in1995-96. These included establishing Communist Party cells in FIEs , doubling commercial and residential rents for foreign enterprises and expatriate staff, imposing a maximum time limit of three years on work permits issued to foreigners employed in FDI projects, restricting foreign capital participation in labour-intensive industries, and imposition a domestic-content and export-performance requirements on FIEs in a number of key industries. This policy backsliding raised serious concerns in the international investment community (Truong and Gates, 1996).

Policy reforms, however, regained momentum following the economic downturn during 1997-99, supporting the adage that ‘bad times lead to good reforms’. A new Enterprise Law that came into force in 2000 introduced a simplified procedures for setting up new enterprises, and permitted conversion of joint-venture FIEs (including joint ventures formed under BCCs) into fully-owned subsidiaries of parent companies. It assured security for private enterprises with a full government guarantee against nationalization or expropriation. FIEs were permitted to open accounts with overseas banks and to mortgage assets attached to land and land-use rights as security for borrowing from credit institutions permitted to operate in Vietnam.

In December 2005, a new unified Investment Law was promulgated in place of the Law on Foreign Investment and the Law on Domestic Investment Promotion. The key features of this landmark legislation included treating foreign and domestic investors equally with regard to investment approval and incentives, providing investors with complete freedom in the choice of the mode of business entry (that is, BBC, joint venture or full ownership), abolishing local-content and export-performance requirements, and introducing a decentralized three-tier system of investment approval. Under the new approval procedure, projects under US$ one million US$ require only business registration (that is, no requirement for investment approval), projects between one and twenty millions are approved at the provincial level, and only projects beyond this investment level require the approval of the central government.

TRADE POLICY

Liberalisation of the foreign investment regime has gone hand in hand with significant trade liberalization (Athukorala, 2006, Auffret, 2003). The Law on Import and Export Duties introduced on 1 January 1988 eliminated the government monopoly on foreign trade and set the stage for the transition from the trade regime based on quantitative restrictions (import quotas and licencing) to a transparent, tariff-based trade regime. But during the next decade or so the tariff structure continued to remain characterised by selective protection of some consumer goods industries (cosmetics and some categories of food products), upstream activities related to textiles and garments (silk, cotton, and certain fibres) and some intermediate goods industries (metal products, cements and glass). Import quotas were used side by side with import tariffs in order to protect manufacturing SOEs from import competition.

From the mid-1990s, Vietnam took initiatives to lock in liberalisation reforms by committing itself to play an active role in regional, bilateral and multilateral trade liberalisation initiatives. In July 1995, Vietnam became a member of the Association of South East Asian Nations (ASEAN) and the ASEAN Free Trade Area (AFTA). In 1994, the USA lifted the long-standing trade embargo against Vietnam. Subsequent negotiations between the governments of Vietnam and the USA culminated in the signing of a bilateral trading agreement (the Vietnam-United States Bilateral Trading Agreement, VNUSBTA) in July 2001. The VNUSBTA, which came into effect on 10 December 2002, was the most comprehensive of all bilateral trading agreements the US has ever signed with a developing country.

In 1995, Vietnam applied for membership in the WTO. The emphasis on WTO accession has gained added impetus following China's accession in 2001. Following a series of preparatory sessions, on 10 December 2003, the WTO Working Party started negotiating terms of Vietnam's membership. During the period of accession negotiations, steps were taken to remove import quota restrictions and to rationalise the tariff structure. Vietnam signed the WTO agreement on 11 January 2007, becoming WTO's 150th member. As part of WTO commitments, Vietnam bound the entire tariff schedule mostly in the 0-40% range, with an average bound rate of 11.5%. In 2003, when the WTO accession negotiations commenced, the simple average tariff rate was about 20%. This declined to 18.5% in 2007 and further to 9.6% in 2017 (WTO, 2018)[ii]. After two-and-a-half decades of reforms, tariffs are now virtually the sole instruments used in regulating import trade in Vietnam, with only petroleum products subject to import quotas and a few items on the prohibited import list based on health and defence considerations.

Firms operating in Vietnamese EPZs have duty free access to inputs used in export production and enjoy various tax concessions comparable to or more attractive than those located in EPZs in other countries in the region. Under a duty rebate scheme introduced in 1991 exports of manufactured goods operating outside EPZs are eligible for reimbursement of import duties paid for imported inputs embodied in export products. In 1993 a duty suspension facility was added to the scheme, enabling export-oriented firms (firms exporting more than 50% of output) to suspend payment of duty on imported inputs up to 90 days. The suspension period was further extended to 275 days in 1998.[iii]

In the early years of market-oriented reforms Vietnam introduced export duties on a number of export items. This was justified at the time on grounds of protecting environment, natural resources conservation and reserve inputs for domestic production. These duties were subsequently eliminated. Since 1998, only two products – crude oil and scrap metal – have been subject to export duties.

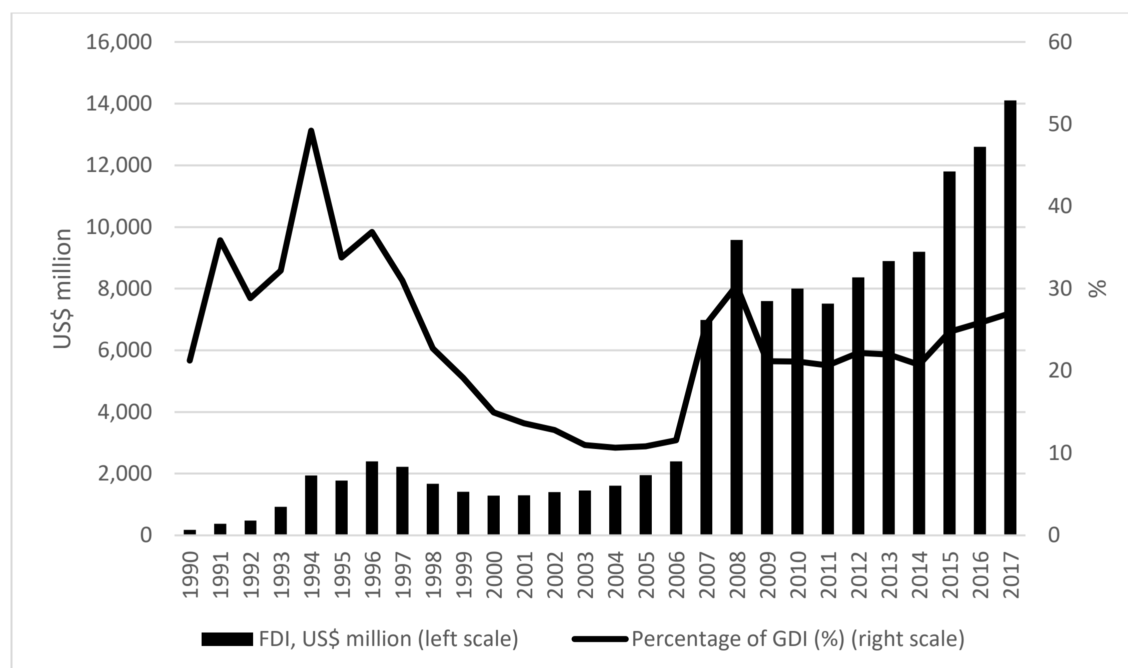
TRENDS AND PATTERNS OF FOREIGN DIRECT INVESTMENT

This section examines trends, source country composition and industry profile of in FDI inflows to Vietnam following the market-reined reforms began in the late 1980s. FDI inflows surged from almost zero in late 1980s to US$180 million in 1990 and to US$ 2587 million in 1997. Following a sharp decline during the next five years, FDI inflows regained momentum from about 2003, with a notable acceleration following the WTO accession in 2006 (Figure 1).

The onset of the East Asian financial crisis in mid-1997 and the subsequent contraction in intra-Southeast Asian FDI was a significant contributory factor for the decline in FDI inflows during 1998-2002. Investors from East Asian countries – in particular Malaysia, South Korea, and Singapore – played a key role in the surge in FDI inflows in Vietnam on the back of the economic boom in their economies in the lead-up to the crisis. These substantial flows were severely disrupted by the onset of the crisis. However, the data on investment approvals show that investor interest in Vietnam country began to wane from about mid-1996 (well before the onset of the East Asian financial crisis), because of the political backlash against foreign firms on the basis of their perceived adverse socio-economic implications (Truong and Gates, 1996; Schaumburg-Muller, 2003). There was also a notable increase in the failure rate of licensed FDI projects (that is, the percentage of withdrawn projects out of total licensed projects) in 1996 and the ensuing three years (Kokko *et al*., 2003, Table 2).

Total FDI inflows in 2017 were US$ 14.1 million, a two-fold increase compared to the figure in a decade ago (US$ 7.2 million 2006). Interestingly, the decline in total world FDI flows during the global financial crisis (2007-2008) is not reflected in FDI inflows to Vietnam (Figure 1). During 2010-2017, FDI amounted to 22.5% of gross domestic investment (GDI), up from 12.5% during 2000-04.[iv] Over the past decade, the FDI-DGI ratio has been the highest in Vietnam after Singapore among the main countries in Southeast Asia (Table 1).

Figure 1: Foreign direct investment in Vietnam: Value (US$ million) and as a percentage of gross domestic investment (GDI), 1990-2017



Source: Data compiled from UNCTAD, *World Investment Report* database.

Table 1: Foreign direct investment inflow as a percentage of gross domestic investment, 1990 -2017[1] (%)

	1990-94	1995-99	2000-04	2005-2009	2010-2013	2014-17
Developing countries	5.7	10.9	11.7	12.1	9.3	9.1
China	9.8	13.6	9.3	6.1	3.5	3.4
Southeast Asia						
Indonesia	0.9	2.66	-5.5	6.8	6.7	7.5
Malaysia	19.4	16.58	10.5	13.6	15.3	14.2
Philippines	7.5	9.48	5.8	8.2	4.6	5.8
Singapore	30.3	33.02	62.9[1]	74.4[1]	88.8[1]	77.7
Thailand	4.4	13.44	14.2	13.3	11.4	8.8
Viet Nam	33.5	27.9	12.5	20.4	21.7	24.2

Notes: 1. Period averages.

2. Figures for these years are 'asset-liability' based where as those for the previous years are directly from balance of payments records (as data for all years for all other countries.

Source: Compiled from UNCTAD *World Investment Report* database.

The ownership patterns of FIES have undergone notable changes over time. During the early years of the reform era, joint ventures, mostly with SOEs, were the dominant entry mode of FDI. During 1988-1994, joint ventures accounted for over 70% of total approved FIEs and 75% of total registered capital of these enterprises. Moreover, the bulk of joint- ventures (over 90%) had state-owned enterprises as the local partners (Kokko et al., 2003). Since then, there has been a significant increase in the share of fully- foreign owned firms among total approved investment (both in terms of the number of projects and value of committed capital) at the expense of the relative position of joint-ventures. By 2017 fully-foreign owned firms accounted for over 76% of total registered investment of FIEs.[v]

The source-country profile of FDI in Vietnam is characterized by a clear East Asian bias (Table 2).[vi] Throughout the reform era, investors from East Asia (Southeast Asia, Northeast Asia and China) have accounted for over 70% of approved FDI. The share accounted for by the USA and the Western European countries is much smaller compared to the source country composition of FDI inflows to the other south Southeast Asian countries (Indonesia, Malaysia, Philippines, Singapore and Thailand) (Athukorala, 2007, Chapter 2). Among the East Asian countries, the relative position of the countries in Southeast Asia has declined over the years as a result of the growing importance of investors from Japan, Taiwan, Korea and, more recently, China. In 2015, Korea topped the list with 29% of approved in that year, followed by Japan (7.4%).

FDI from the USA and the Western European countries in Southeast Asian countries is heavily concentrated in assembly activities in vertically integrated high-tech industries, mostly in electronics ad automobile (Lipsey, 1998; Athukorala, 2007, Chapter 2). Investors in these product lines place a much greater weight on the stability and transparency of the domestic investment climate compared to their counterparts in the standard export-oriented labour-intensive products (like clothing or footwear) or

domestic-market oriented industries. This cautious approach seems to explain the relatively small share of these countries in total FDI inflows to Vietnam.

Table 2: Source country composition of approved foreign direct investment, 1988-2005, 2006-10, 2011-15 and 2016

	1988-2005[1]		2006-2010[1]		2011-2015[1]		2016	
	Number of projects	Registered capital (US$ million)	Number of projects	Registered capital (US$ million)	Number of projects	Registered capital (US$ million)	Number of projects	Registered capital (US$ million)
Japan	684	6907	741	14052	1489	18014	351	3056
China, PR	431	841	339	2839	526	6494	283	2137
Hong Kong	---	---	622	7846	353	7701	168	1681
South Korea	1185	6145	1504	16244	2271	26802	849	7965
Taiwan	1615	8657	556	14324	307	8016	125	2194
Indonesia	21	286	5	-82	20	193	8	27
Malaysia	214	1772	162	16645	147	-4997	41	940
Philippines	35	346	17	190	20	48	2	55
Singapore	484	9327	411	12563	649	13259	213	2415
Thailand	182	1633	58	4210	179	1884	35	732
Australia	161	1514	79	743	117	479	45	467
Denmark	36	182	55	412	27	88	8	238
France	217	2834	104	120	127	469	41	205
Germany	---	---	162	811	98	583	21	80
Italy	32	106	7	82	30	170	11	41
Netherlands	80	2420	65	3061	110	2784	16	92
Switzerland	48	978	30	747	33	320	8	57
United Kingdom	89	1985	48	237	104	2517	48	230
USA	319	2304	249	1081	213	1503	65	430
Other countries[2]	603	11426	813	29065	786	4289	275	3848
Total	6436	59663	6027	134909	7606	87311	2613	26890

Notes: 1. Period total

2. Includes projects financed by capital sent through companies registered in tax-haven countries (Cayman Island, Channel Island, Cook Inland, Mauritius, Panama and Liechtenstein).

--- Data not available.

Source: Compiled from General Statistical Office, *Statistical Yearbook of Vietnam*, Hanoi (various issues

During the early years of market-oriented reforms in Vietnam, analysts often referred to the US economic embargo as a major constraint on the country's ability to rely on FDI in the process of economic transition. However, interestingly the lifting of the embargo in 1994 and the signing of the Vietnam-USA Bilateral Trade Agreement in 2001 did not immediately bring about a significant change in the source country composition of FDI in Vietnam. The share of US investors in total approved investment in realized project amounted to a mere 1.5% between 2000 and 2005 (Table 3). The first large investment project by a US electronics multinational enterprise (MNE) (Intel Corporation, see below) in Vietnam materialized only in 2006. By then, Vietnam's commitment to market-oriented reforms and promoting FDI had become firmly rooted.

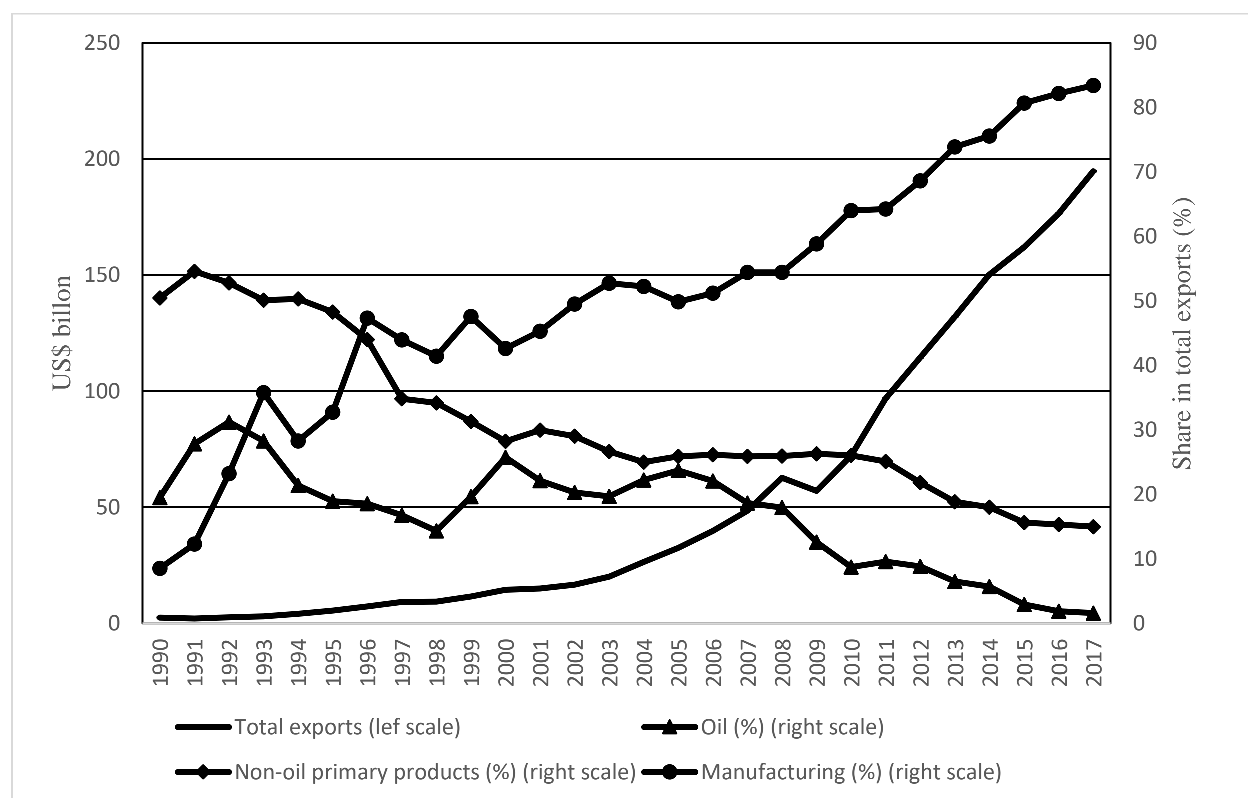
In the early reform years, offshore petroleum and gas extraction, and construction and services sectors were the major areas of attraction to foreign investors, with the manufacturing sector accounting for less than a fifth of registered investment in total approved projects. From about the late 1990s, FDI in manufacturing begun to increase during the ensuing years over the years. During 2010-14 over 60% of total realised FDI was in manufacturing. During the early years, much of FDI investment in manufacturing was in production for the domestic market. Less than 20% of total approved projects during 1988-90 had export-output ratios of over 50%. From the late 1990s there has been a notable compositional shift in manufacturing FDI from domestic market-oriented to export-oriented production. By 2008, over 70% of approved FIEs in manufacturing had export-output ratios of over 50%, with the majority clustering within 80-100% range (Athukorala and Tien, 2013).

Export performance

Export response to Vietnam's liberalisation (*doi moi*) reforms has been impressive (Riedel and Comer, 1997; Athukorala, 2009; Thanh, 2005). Value of total merchandise exports (in current prices) quadrupled between 1985 and 1990 (from US$ 699 million to US$ 2404 million), surpassed $50 billion mark in 2007

and reached US$ 195 billion in 2017 (Figure 2). Until about 1992, crude petroleum accounted for a large share of export increment, a result of earlier foreign investment in the White Tiger field. From then on there were clear signs of a take-off of non-oil exports, firstly agricultural products and then manufactured goods. Primary products accounted for nearly a half of non-oil merchandise exports from Vietnam in the mid-1980s. This share increased further in early years of the post-reform period as the first positive response to reforms came from agricultural products, mostly rice (Dollar, 1992). Throughout 1990s, rice was the dominant export earner among agricultural exports. The dominance of rice within primary exports significantly eroded over time as a result of both declines in export value in absolute terms and the rapid expansion of other traditional agricultural products (mostly coffee and rubber) and, more importantly, processed food, in particular fish and fish preparations.

Figure 2: Vietnam's merchandise exports: value (US$ million) and composition (%), 1990-2017



Source: Data compiled from the UN *Comtrade* database

Table 3: Share world manufacturing exports: Vietnam and other five major AEAN countries

	2000-01	2004-2005	2009-2010	2014-15	2016-17
Indonesia	0.8	0.6	0.6	0.6	0.6
Malaysia	1.7	1.5	2.3	3.1	2.9
Philippines	0.7	0.6	0.5	1.1	1.1
Singapore	2.5	2.1	4.4	6.2	5.8
Thailand	1.1	1.2	2.5	3.7	3.6
Vietnam	0.1	0.2	0.5	1.1	1.5

Source: Compiled from UN Comtrade database.

From about the late 1990s rapid export growth has been mainly driven by manufacturing. The share of manufacturing in merchandise exports increased continuously from 40% in 1995 to 83% by 2017 (Figure 2). Over the past decade or so, the degree of world market penetration of manufacturing exports from Vietnam, as measured by the share of total world manufacturing exports, has been faster than that of the other major economies in Southeast Asia (Figure 2). Vietnam's share in world manufacturing exports increased from 0.18% in 2004-5 to 1.5% in 2016-17; when it was well above those of Indonesia (0.9%) and the Philippines (1.1%).

In the 1990s, manufacturing exports from Vietnam were heavily concentrated in traditional labour-intensive products, in particular apparel, furniture and footwear (classified as miscellaneous manufacturing (Section 8) on the Standard International Trade Classification (SITC)) (Table 3). These three products categories accounted for over two-thirds of total manufacturing exports during this period. There has been a notable diversification of the commodity composition in the new millennium, particularly over the past ten years, reflecting rapid integration of Vietnamese manufacturing into the East-Asia centred global production networks. The export shares of products belonging to the commodity class of machinery and transport equipment (SITC 7), in particular information and communication technology (ICT) products (office machines (SITC 75)), telecommunication and sound recording devices (SITC 76) and semiconductor's (SITC 772 and 776) have recoded impressive growth. These are the

products in which the on-going process of global production sharing[vii] is heavily concentrated (Athukorala, 2014).

The data plotted in Figure 3 specifically focus on the role of global production sharing in manufacturing exports from Vietnam. The share of total 'network products' (parts and components, and final assembly) remained around 20% until about the end of the first decade in the new millennium. Since then it has increased sharply reaching 45% in 2014. However, Vietnam is still at the early stage of integrating into global production networks, compared to Singapore, Malaysia and Thailand, even though its performance has already been much more impressive compared to Indonesia (Athukorala and Kohpaiboon, 2015). As discussed in the next section, the indications are that the share of networks products in Vietnam's export composition is bound to increase rapidly in years to come. At present, parts and components accounts for the lion's share of total network product exports from Vietnam (77% in 2014) (Figure 3). With a large surplus labour pool, the country has the potential for becoming a large final assembly centre within global production networks.[viii]

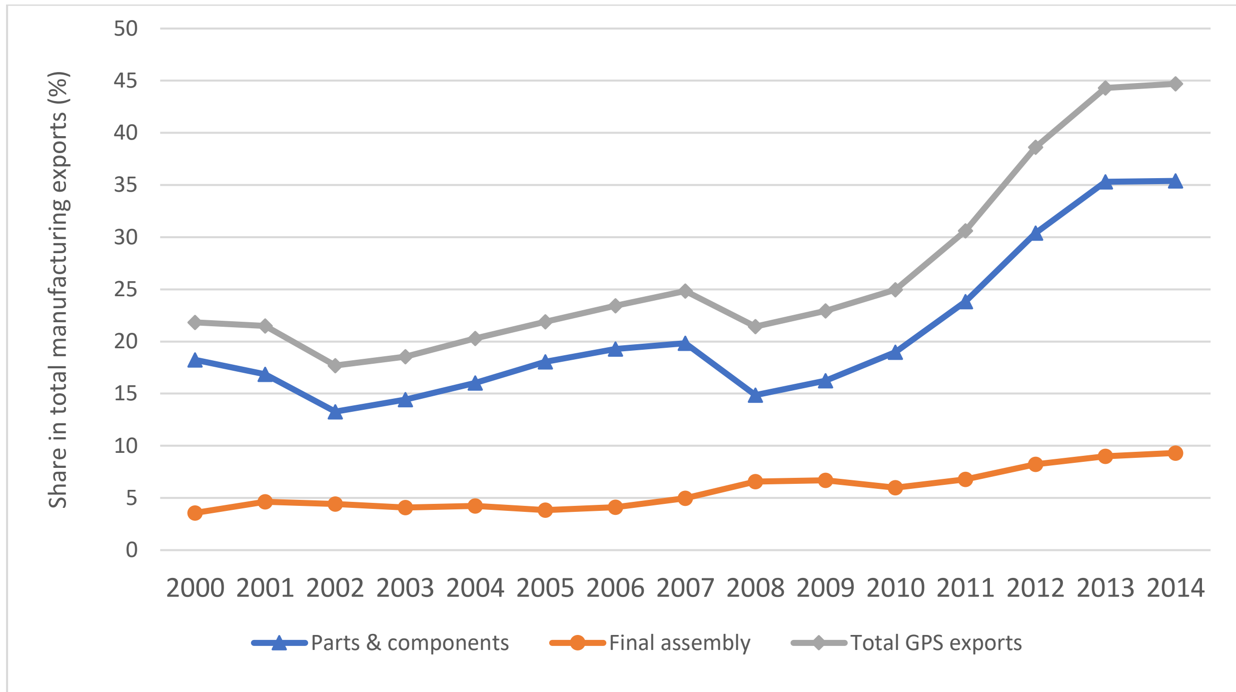
Table 3: Commodity composition of manufacturing Exports from Vietnam, 1992- 2014 (annual averages, %)

Product description[1]	1992-93	1999-00	2004-05	2009-10	2013-14
Chemicals (SITC5)	1.7	1.8	3.2	4.1	4.1
Resource-based products (SITC 6)	13.2	12.7	12.5	17.0	14.7
Textile (SITC65)	5.7	4.4	4.1	4.8	3.3
Machinery & transport equipment (SITC 7)	5.1	12.9	19.0	19.5	39.2
Power generating machines (SITC 71)	0.1	0.8	1.2	1.8	1.3
Specialized industrial machinery (SITC 72)	0.5	0.7	0.8	0.6	0.6
Metal working machinery (SITC 73)	0.1	0	0.1	0.1	0.1
General industrial machinery (SITC 74)	0.3	1	0.7	1.3	1.2
ICT products (SITC 75+76+772+776)	0.3	6.5	9.1	7.9	28.6
Office machines (SITC 75)	0	0.3	5.1	1.1	4.2
Telecommunication and sound recording devices (76)	0.2	1.5	1.5	5.6	23.2
Semiconductors/semiconductor devices (SITC 772+776)	0.1	4.7	2.5	1.2	1.2
Electrical goods (SITC 77-772-776)	0.6	3.1	4.5	5.0	4.6
Road vehicles (SITC 78)	3.1	0.8	2.4	1.6	1.8
Other transport equipment (SITC 79)	0.2	0	0.1	1.1	1.1
Miscellaneous manufacturing (SITC 8)	79.8	74.6	65.2	59.4	42.0
Furniture and other wood products (SITC 82)	1.8	5.6	8.1	7.2	4.5
Travel goods (SITC 83)	6.2	11.2	10.0	9.0	6.5
Apparel and clothing accessories (SITC 84)	55.9	24.8	30.0	25.3	19.2
Footwear (SITC 85)	1.2	6.2	19.5	12.5	10.0

Professional and scientific instruments (SITC 87)	0.1	0.2	0.4	0.6	0.7
Photographic apparatus (SITC 88)	0.1	0.8	0.4	1.4	2.0
Total manufacturing	100	100	100	100	100
US$ million	768	6151	14,881	37,432	97,039
Memo item: Manufacturing share in merchandise exports	30	46.7	50.5	57.9	68.8

Note: 1: Standard International Trade Classification (SITC) product codes are given in brackets. Source: Compiled from UN Comtrade database.

Figure 3: Share of 'global production sharing' (GPS) products in manufacturing exports from Vietnam, 2000-2014 (%)



Source: Compiled from Comtrade database using the commodity classification described in Athukorala (2014) for separating exports based on global production sharing (parts & components and final assembly exported within global production networks.

During the pre-reform era Vietnam's geographic patterns of export (and of course foreign trade in general) was characterised by a heavy concentration in central planned economies in the Soviet bloc.[9] By 1985 almost two-thirds of Vietnam's exports was to these markets. During the early years of the reform period, market diversification was mostly the outcome of rapid expansion in exports to the regional markets. The combined share of exports to East Asia countries remained virtually unchanged around 60% during the ensuing decade, with the Southeast Asian countries accounting for about a fifth of total exports. Exports to the European and North American markets began to expand rapidly with a considerable time lag, and gathered momentum from the late 1990s. The combined export share to Europe and North America accounted for nearly a half of total exports by 2014. The entry of Vietnamese products to the USA remained virtually barred by the trade embargo, which lasted until 1994. The US share in total Vietnamese export begun to increase following the lifting of the embargo, reaching 4.8% by the end of 1990s. Vietnam -US trade received further impetus for the market entry concession given under the bilateral trading agreement signed in 2001. In

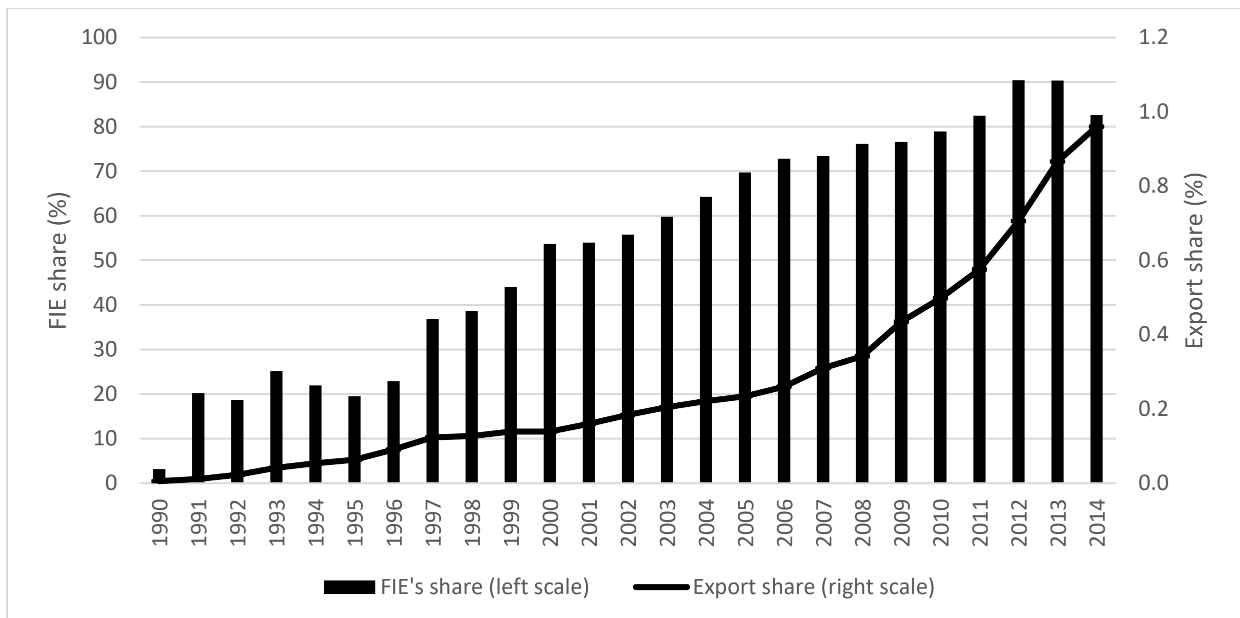
2014 the USA absorbed almost a quarter of total merchandise exports from Vietnam. This share is bound to increase rapidly given the recent entry of Intel Corporation and a number of other USA-based MNEs into Vietnamese manufacturing as discussed in the next section. The export market share of China has expanded rapidly, against the backdrop of an overall decline in the relative importance of regional markets. At the beginning of 1990s, China absorbed less than one percent of total non-oil exports from Vietnam. This figure had increase 10.2% in 2014.

THE ROLE OF FDI IN EXPORT PERFORMANCE

Foreign direct investment has played a pivotal role in the expansion of manufacturing exports from Vietnam (Figure 4). Until about the mid 1990s, FIEs accounted for about 20% of total manufacturing exports. Since then there has been a continuous increase in this share, accounting for over 80% over the past few years. The data clearly show a close relationship between the FIE participation in manufacturing exports and Vietnam's share in world manufacturing exports. This relationship suggests that FIE participation in the Vietnamese economy during the reform era has unequivocally been export creating.

During the early years of reforms, the standard labour-intensive goods (in particular, textile and garments, footwear and miscellaneous manufactures) dominated the export composition of FIEs (Athukorala and Tien, 2013). From about the early 2000, electrical machinery and apparatus have emerged as the single most important export line of FIEs operating in Vietnam. These emerging export patterns were indicative of the role of FDI in linking Vietnam to rapidly evolving regional production networks based on its comparative advantage in labour-intensive tasks within global production networks. At the beginning these product lines in Vietnam were dominated by small- and medium- scale foreign investors (predominantly by Taiwanese firms), the only large global player being Hitachi Corporation from Japan.[10]

Figure 4: FIEs' share in manufacturing exports from Vietnam and Vietnam's share in World Manufacturing Exports



Source: Based on data compiled from Vietnam General Statistical Office (FIE's share), Statistical Yearbook (various issues) and UN *Comtrade* database (export share).

The decision made in 2006 by Intel Corporation, the USA-based world's largest semiconductor producer, to set up an assembly and testing plant in Ho Chi Minh City in South Vietnam marked a watershed in plugging in Vietnamese manufacturing industry into global production networks. The construction of the US$1.2 billion factory began in 2007 and it started production in 2010. It is the largest assembly and testing facility in Intel's global production networks and would employ over 3000 workers at full capacity (Altman, 2007; Intel, 2010).

There is evidence of a herd mentality in the site selection process of electronics multinational firms, particularly if the first entrant is a major player in the industry. Interestingly, following Intel's entry, a similar process has unfolded in Vietnam. Taiwanese-based Hon Hai Precision Industry (Foxconn); the world's biggest electronics contract manufacturer came to Vietnam in 2007. The other major players in electronics industry which have subsequently set up production facilities in Vietnam include Compal, Nidec, Nokia, Panasonic, Tamron, Microsoft, Samsung, LG and Bridgestone, Jabil Circuits (Wall Street Journal, 2007; Bland, 2012; Lewis, 2016; Nikkei Asian View, 2014).

In 2009, Samsung Electronics set up a large plant in Hanoi to assemble handheld products (HHPs) such as smartphones and tablets. In the subsequent years Samsung has been gradually shifting HHP assembly from its plants in Chinato its Vietnamese is response to increasing wages and rental cost in China. During next five years, four electronics parts and component producing subsidiaries of the Samsung group (Samsung Display, Samsung Electro-Mechanics, Samsung SDI, Samsung SDS) also set up operations in Vietnam.[11] In 2009, 65 percent of Samsung's' global HHP supply came from China, with Vietnam contributing a mere 3 percent; by the end of 2012 these figures had changed to 45 percent and 33 percent, respectively. In 2012, Samsung's total exports from Vietnam amounted to 11 percent of Vietnam's total merchandize exports (Athukorala and Kohpaiboon, 2015). Vietnam is now the largest mobile phone manufacturing base for Samsung (Business Korea, 2014).
Given the arrival of these global players in electronics and electrical machinery industry, global production sharing is likely to be the prime mover of export-led industrialization in Vietnam in years to come Trade and foreign investment reforms implemented over the past three decades are now deep rooted to win investor confidence. Moreover, proximity to the other East Asian countries which are deeply embedded in global production networks, ample availability of trainable labour at a wage rate that is much lower compared to all these countries[12], and political stability are main attractions of Vietnam as a production base or MNEs involved in global production sharing.

FIEs, in addition to their direct contribution to export expansion, seem to act as conduits for the expansion of exports by local firms (both SOEs and newly emerging private firms) by opening up marketing channels (Kokko and Sjoholm, 2006). For instance, following the entry of foreign firms into garments and other light consumer goods industries, many *international buying groups*, which had long-established market links with these firms, expanded their global procurement networks to cover Vietnam. These buying groups have subsequently begun to procure supplies directly from local firms. Moreover, in some export-oriented industries MNEs carry out production in Vietnam entirely through sub-contracting arrangements with pure local firms (e.g. Nike in footwear and Ikea in furniture), while directly engaging only in procurement and marketing tasks through liaison offices. The recent entry of global electronics and electrical firms has begun to open up subcontracting opportunities for local entrepreneurs. For instance, the Saigon Hi-Tech Park has begun to emerge as an investment hub bringing together foreign investors with domestic companies in setting up assembly and testing plants linked to regional production networks (*The Wall Street Journal*, 2007).

In sum, there is clear evidence from the Vietnamese experience that under a liberal trade and investment policy regime, which help unleash natural export potential of the country, FDI can play a

pivotal role in linking domestic manufacturing to global markets. The implications of this emerging FDI-propelled process of export-led industrialisation for long-term growth and development of the economy remain an important subject for further research. The lack of 'industrial deepening' of the merging specialisation patterns of the merging specialisation patterns ─ limited domestic backward linkages of export-oriented industries and their failure to nurture domestic research and development capabilities ─ is often emphasized in the Vietnamese policy debate as a barriers to long-term growth. Whether this is a structural feature of export-oriented growth in this era of global production sharing (and hence is beyond the influence of domestic policy makers) or is it due to remaining impediments to private-sector operations in the economy remain unresolved issues in this policy debate (Leung, 2015; Riedel, 2015; Sturgeon and Zylberberg, 2016).

CONCLUDING REMARKS

This chapter has surveyed trade and investment policy reforms in Vietnam and emerging patterns of foreign direct investment and export performance over the past three decades. Particular emphasis has been placed on the role of foreign direct investment in linking Vietnamese manufacturing sector into the East-Asia centred global production networks. The evidence pieced together in the chapter from related literature and some fresh data tabulations clearly illustrate the pivotal role of concurrent liberalisation of foreign investment and trade policy regimes in Vietnam's transition from central planning to an increasingly market-oriented economy. When market forces unleashed, albeit in a constrained fashion, specialisation patterns of the economy assert themselves in line with the country's potential for global economic integration.

In the East Asia context, Vietnam's performance in manufacturing exports stands out for the prolonged heavy concentration in traditional labour-intensive manufacturing, in particular apparel, footwear and furniture. However, the analysis of the changing commodity mix of exports and patterns of FDI reveals clear early signs of diversification of the export mix into dynamic product lines, in particular electronics and electrical goods. Normalisation of economic relations with the USA, significant reforms of investment and trade policy regimes and the accession to the membership of the World Trade Organisation have been instrumental in setting the stage for linking the Vietnamese manufacturing to global production networks. In response, a number of major players involved in global production sharing have already entered Vietnamese manufacturing. The indications are that electronics and electrical goods are going to play the dominant role in expanding manufacturing exports in years to come, replicating the specialisation patterns of the dynamic East Asian countries, which are well integrated into global production networks.

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Notes:

[i] Enterprises with capital directly investment by foreigners, entirely (in fully foreign-owned firms) or partly (in joint-ventures with local parties).

[ii] Comparable figures in 2017 for the other major Southeast Asian countries are Indonesia 6.9, Malaysia 6.1, Philippines 6.3, and Thailand 11.6 (WTO 2018)

[iii] Currently (February 2018) there are four EPZs in Vietnam, three of which are in Ho Chi Minh City (Tan Thuan and Linh Trung I, II); the newest EPZ, Linh Trung III, is in Tay Ninh Province.

[iv] FDI-GDI ratio was much higher during 1990-99 compared to that for 2005-2013, but this mainly reflects the lower level of GDI during the former period (the denominator).

[v] Data reported in this chapter, unless otherwise stated, are based on General Statistical Office, *Statistical Yearbook of Vietnam* (various issues).

[vi] Data on the source country composition of FDI need to be treated with caution because some MNEs financed FIEs with capital sent through companies registered in tax-haven countries (Cayman Island, Channel Island, Cook Inland, Mauritius, Panama and Liechtenstein).

[vii] *Global production sharing* is 'the splitting of the production process (of a good or a service) into discrete tasks, which are located in countries in which factor prices are well matched to the factor intensity of the particular task (Feenstra 1998). The alternative terms used to refer to this phenomenon include vertical specialisation, international production fragmentation, vertical specialization, and slicing the value chain. Interrelations among a set of firms specialising in different segments of the production process of a given product as a single economic group is referred to as *global production networks* (GPNs). Trade within GPNs includes both parts and components (for example, semiconductors exported by Intel from Vietnam) and final assembly (mobile phones exported by Samsung from Vietnam). For details on the global production sharing in the expansion of manufacturing exports from the East Asian countries, see Athukorala 2014 and Athukorala and Kohpaiboon 2015).

[viii] Final assembly within global production networks are generally much larger operations requiring employment of larger workforce compared to parts and components production/assembly (Junes 2000, Chapter 9). This is considered as one of the main reason for virtual disappearance of final assembly from Malaysia and Singapore, and to a significant extent from Thailand, following the emergence of China as the premier assembly centre within regional production networks.

[9] This paragraph draws on Athukorala (2009), with data updated to 2014 using the same data source.

[10] Hitachi plant in Ho Chi Minh City commenced operation in 2000. It assembles parts and components for a wide range of consumer electrical goods and currently employs about 4000 workers.

[11] Buy 2014 , the total investment of Samsung group in Vietnam (the combined investment of these four subsidiaries and four other subsidiaries: Samsung Heavy Industries, Samsung Life Insurance, Samsung Fire Insurance, and Cheil Worldwide) amounted to US$9.1 billion (Business Korea 2014).

[12] The monthly wage of a factory worker in Vietnam varies in the range of US$100 to 150, compared to the average wage of over US$350 in the manufacturing clusters in China.