ISSN 2335-6677

#34
2014

ISEAS perspective

RESEARCHERS AT SINGAPORE'S *INSTITUTE OF SOUTHEAST ASIAN STUDIES* SHARE THEIR UNDERSTANDING OF CURRENT EVENTS

Singapore | 2 June 2014

REFORMS WILL DECIDE VIETNAM'S ABILITY TO RESIST ECONOMIC DOMINANCE BY CHINA

*By John Lee**

EXECUTIVE SUMMARY

- Defined by geography, by the troubled history between the two countries, and by the huge asymmetry of power, Vietnam pursues a counter-dominance strategy towards China even as it adopts a softly-softly diplomatic approach to relations with its northern neighbour.

- This strategy seeks to prevent over-reliance on the far larger Chinese economy and the possibility of China economically punishing Vietnam for the latter's policies

- While China has emerged as Vietnam's largest trading partner by volume, and Vietnamese dependence 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.

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- Likewise, Vietnamese reliance on Chinese capital in the form of foreign direct investment is narrow and limited to a small number of sectors – a condition that denies Beijing significant strategic leverage over Hanoi.

- Even so, a failing reform process in Vietnam will cause other foreign firms and external capital to lose interest in its economy. This would deliver a considerable blow to Hanoi's attempts at balancing and mitigating the influence of China through lessening reliance on Chinese trade, investment and other forms of largesse such as concessionary loans and aid.

INTRODUCTION

Now Vietnam's largest trading partner by volume, there is speculation that China's economic dominance could threaten Vietnam's long-standing counter-dominance and balancing strategy vis-à-vis a much larger and more powerful neighbour.

This *Perspective* 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. This is clear from analysis of the scale and structure of Vietnam's trade and investment relationships with major partners.

However, whether Vietnam's counter-dominance plans can remain successful into the future is uncertain even if they are 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-dominance strategy. But a failing reform process would mean that an increasingly vulnerable Communist Party of Vietnam (CPV) may well become more reliant on Chinese firms and on Beijing for economic largesse – and therefore more susceptible to the strategic and other demands of its enormous neighbour.

SINO-VIETNAMESE 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 to US$41.1 billion in 2012.[1] This indicates China's enormous importance to Vietnam's current and future trade-driven growth and development strategy.

In fact, and despite its status as Vietnam's largest trade partner, China is less important to Vietnam's export-oriented growth strategy than the two-way trade numbers suggest. The first and most obvious clue suggesting this is found in Vietnam's major export destinations.

[1] World Trade Organisation figures.

Table 1: Vietnam's major export destinations (%)

	China	Japan	U.S.	E.U.	ASEAN	Rest of Asia-Pacific	Rest of the world
2002	9	15	14	20	14	10	18
2012	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. which has increased every year since 1997.[2]

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 reaffirmed by the changing make-up of Vietnamese exports.

Table 2: Vietnam's exports by category (%)

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

Source: General Department of Vietnam Customs

From *Table 2,* we can see that while resources and agricultural products have become less important in relative terms, and while traditional Vietnamese low valued-added manufacturing sectors such as garments and footwear remain important, the

[2] U.S. Census Bureau figures.

most rapid growth sectors are Hi-Tech sectors which include electronics and computers, cell phones and accessories, and transport vehicles and parts. In 2013, and 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 overtook the previous leading low-cost manufacturing category of textiles and garments which generated US$17.9 billion in export earnings.[3]

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 were US$18.6 billion, US$11.2 billion and US$2.3 billion respectively.[4] In the important sub-category of cell phones and accessories, in 2013, the U.S and EU made up a combined 41.6 per cent of Vietnam's exports. This compares to China receiving a mere 2.44 per cent of Vietnamese exports in this sub-category in the same year.[5]

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

Table 3: Chinese imports into Vietnam (% of total Vietnamese imports)

	2002	2008	2009	2010	2011	2012	2013
% of total imports	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.)[6] If the mutually agreed trade target of US$60 billion is reached in 2015,[7] and based on current ratios, Vietnam would have an estimated trade deficit of US$28.32 billion with China. This estimated trade deficit with China equates to over 15 per cent of GDP based on World Bank estimates

[3] General Statistics Office of Vietnam figures.

[4] 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.

[5] General Statistics Office of Vietnam figures; author's calculations.

[6] General Statistics Office of Vietnam figures; author's calculations.

[7] 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> accessed February 18, 2014.

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 increase in trade being a 'win-win' for both sides,[8] much of the conversation within Vietnam is about ways to reduce or eliminate the trade deficit with China.[9]

The nature of Chinese imports into Vietnam is also noteworthy. Major categories of Chinese imports into Vietnam for 2013 are listed below.

Table 4: Major categories of Chinese imports into Vietnam, 2013

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

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

Below are major categories of Vietnamese exports to China for 2013.

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

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

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

[8] 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> accessed February 19, 2014.

[9] 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.

We can draw some conclusions from the above tables. One is that Vietnam's leading exports to China tend to be low value-added products such as 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.[10] Indeed, an analysis of Sino-Vietnamese trade in intermediate goods from 2000-2009 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.[11] This is consistent with the trend in Chinese trade in that intermediate goods have increased as a share of exports from around 45-50 per cent at the beginning of this century to 55-65 per cent currently.[12]

In summary, Vietnam's increasingly export-oriented growth model depends more on tapping into the large advanced industrialised economies such as the U.S. and E.U. than it does on the Chinese consumer market.[13] 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.[14] In this context, consumer demand in advanced economies is far more important for Vietnam's economic prospects than such demand from China, with Chinese consumers preferring Japanese, South Korea, American and European branded consumers goods.[15] 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., Japan and South

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[10] 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).

[11] 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).

[12] 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.

[13] 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.

[14] 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.

[15] 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.

Korea are far more important to Vietnam-based firms than consumers in China. As the 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, and 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.

But while China may be 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 nevertheless creating vulnerabilities for Hanoi? Such dependency also applies to sectors that are important to Vietnam such 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.[16]

In reality, 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 60 per cent of China's exports – intermediate goods and finished products.[17] This is even more pronounced in the electrical machinery, general machinery and chemical industries which dominate intermediate good trade between Vietnam and China.[18] 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.[19] Since foreign commercial entities and interests invest in China for purely commercial reasons, Chinese officials would find it extremely difficult to force or persuade these foreign entities and interests to do their political bidding, for example by issuing directives to China-based export manufacturing companies to boycott certain countries for political or strategic reasons. 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.

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[16] See "Vietnam sources 50% of textile raw materials from China," *Fibre2Fasion.com*, October 30, 2013 <http://www.fibre2fashion.com/news/textile-news/newsdetails.aspx?news_id=154817> accessed February 19, 2014.

[17] 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> accessed February 18, 2014.

[18] See Ralph Paprzycki and Keiko Ito, "Investment, Production and Trade Networks as Drivers of East Asian Integration," pg. 7.

[19] 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.

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 processe, and the sourcing of parts, components, expertise and labour that might go into making an intermediate good that is eventually shipped from China to Vietnam. For example, manufacturing firms split production processes into various stages and relocate these to multiple partners in different countries. Parts and components are purchased from multiple suppliers that are sometimes affiliated with that firm and at others times are third-party and 'blind' suppliers from various countries. Assembly of the finished or intermediate part is outsourced to multiple partners, or else non-affiliated contractors from various countries. When it comes to the electronics sectors 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.

In terms of the sub-region, China is seeking to extend its leadership in the Greater Mekong Sub-region (GMS) development programme,[20] which is backed by the Asian Development Bank, and would be reluctant to jeopardize its standing within this grouping which would result 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 GMS region is seen as essential for the development of China's southern provinces.

FDI AND THE ROLE OF CHINESE INVESTMENT IN VIETNAM

a) The Importance of FDI

The growing importance of FDI to Vietnam can be seen in its increase in volume and flow into the country since implementation of Doi Moi policies. The stock of FDI in the country has increased from US$243 million in 1990, to US$14.74 billion in 2000,

[20] 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>; 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.

and to US$72.53 billion in 2012[21] – an almost 300-fold increase over the period. This compares to just under a 22-fold increase for the whole of Southeast Asia over this same period.[22]

Almost all FDI is also 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 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.[23]

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

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

	1995	2000	2005	2010	2012
a. GDP					
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
Industrial Production					
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)

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

[21] 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.

[22] 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> accessed February 24, 2014; author's calculations.

[23] 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.

country in 2013, suggesting that the upward trend for the importance of FDI is continuing.[24]

b)Sources of FDI

Let's look at where the FDI comes from. It is clear that China is far from a dominant foreign investor into Vietnam. When we look at figures for 'Charter Capital', which measures the foreign capital that has been converted into equity shares and reflected in the Charter of any firm, China is behind only 3.26 per cent of all such capital stocks in Vietnam.[25]

Table 7: FDI by Country Source in Vietnam (US$ billions) – Accumulation of projects still valid as of Dec 31, 2012)

	Total Registered-invested Capital	% of Total Registered-invested Capital
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

[24] 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.

[25] Foreign Investment Agency, Vietnam figures; author's calculations.

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.[26] It is true that in the first ten months of 2013, preliminary 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.[27] However, these large infrastructure projects tend to be relatively infrequent, while South Korea and Singapore still invested significantly more than China during that period.[28]

In summary, and 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, Vietnam is more dependent on private sector firms from advanced economies such as Japan, South Korea, Singapore, Taiwan and the U.S. than it is 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.[29]

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 an economic or political threat.

Although reliance on Chinese capital and 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; and the building of much needed power plants tend 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."[30]

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[26] Foreign Investment Agency, Vietnam figures; author's calculations.

[27] 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> accessed February 24, 2014.

[28] 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.

[29] See Oliver Hensengerth, *Regionalism in China-Vietnam Relations: Institution Building in the Greater Mekong Subregion*, pg. 99.

[30] 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.

THE ROAD AHEAD…

Despite Vietnam's stellar economic performance in the current Doi Moi period, there are challenging times ahead for the country. Rapid advances in manufacturing value-add and industrial capacity ARE likely to be driven by MNCs from advanced economies. These international firms realise the *potential* of Vietnam as a manufacturing and perhaps services hub but are not yet prepared to decisively shift operations into Vietnam at the expense of countries such as China, Thailand and Malaysia.

As it stands, Vietnam's business 'enabling environment' is still comparatively poor. For example, Vietnam is a mediocre 99 out of 189 countries in the World Bank's *Ease of Doing Business* rankings. This compares unfavourably to middle-income ASEAN+3 countries to which Vietnam aspires. Malaysia is 6^{th} and Thailand is 18^{th}.[31] Likewise, in Transparency International's *Corruption Perceptions Index*, Vietnam is ranked a low 116 out of 175 countries (below Malaysia at 53 and Thailand at 102.)[32] In the *International Property Rights Index*, Vietnam is 90 out of 130 countries (with Malaysia 33 and Thailand 71.)[33] 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.[34]

Improving the enabling environment means improving on 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 innovating firms, and not just government-preferred SOEs. Improvements in these areas would lower transactions costs, encourage greater entrepreneurialism, and create a more predictable and stable environment for individuals and firms.

Besides the incapacity to sustain rapid economic growth, the strategic implications of a failing reform process can be immense for Vietnam. Such failure 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 to Hanoi's attempts to balance 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.

Moreover, Vietnam's reform stasis would mean that the country is unlikely to fulfil the conditions needed to meaningfully join and participate in the American-backed

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

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

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

[34] World Economic Forum's *Global Competitiveness Index, 2013-2014* <http://www3.weforum.org/docs/GCR2013-14/GCR_Rankings_2013-14.pdf> accessed February 26, 2014.

Trans-Pacific Partnership (TPP).[35] 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 which would enhance trade and investment considerably.[36] If so, and without the economic relationship progressing as expected, genuine progress made in the 'Comprehensive Partnership' between Hanoi and Washington would be significantly slow.[37]

But returning to the current period, China's current economic leverage over Vietnam should not be overstated. Vietnam's geography and history mean 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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[35] See Khanh Vu Duc, "Vietnam squanders reform opportunity," *Asia Times*, December 11, 2013 <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.

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ISEAS Perspective is published electronically by the Institute of Southeast Asian Studies, Singapore.

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