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A New Day Dawns for Vietnamese FDI

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INTRODUCTION

On February 28th, 2006 Intel Corporation announced its decision to invest $300 million to create a semiconductor assembly and testing facility in Vietnam. Intel Chairman Craig Barrett while in Ho Chi Minh City (formerly known as Saigon) stated, "We applaud the progress the country has made in building up their technology infrastructure and support of education programs to advance the capabilities of the local workforce."

The Intel investment represents the largest U.S. non-oil investment in Vietnam. Prior U.S. investment had mainly been in low-tech manufacturing such as shoes, food processing and textiles. Vietnam has experienced a sizable, ongoing increase in FDI in recent years, and political leaders hope to expand an economy and improve living standards shattered by wars and poor prior economic performance. While Vietnam has a number of attractive features to foreign investors, some analysts question the desirability of investing in a country that has only recently experienced political stability and economic freedom.

VIETNAM

Located in Southeast Asia, **(Exhibit 1)** Vietnam has attracted the attention of Western governments since at least the 19th Century. In 1858 the French colonized Vietnam. After internal fighting in an eight-year war, the French signed the Geneva Agreement in 1954 which led to their withdrawal from the country and the division of Vietnam into the communist north and noncommunist south. The Geneva Agreement required elections to be held for unification, however, the government in the south refused to participate and proclaimed itself the Republic of Vietnam. Armed conflict between the communist north and noncommunist south started shortly thereafter and intensified as the decade progressed.

U.S. involvement commenced in 1961 as President Kennedy sent U.S. military advisors to Vietnam. In 1965 President Johnson sent military combat forces to Vietnam. The war in Vietnam escalated, and without a clear sign of victory the American public grew increasingly tired of the conflict. In 1973 a peace agreement was reached and the U.S. withdrew its military forces. Within two years the communist government from the north invaded the south and unified the country into the Socialist Republic of Vietnam. Many Americans felt the United States had lost the war in Vietnam and still harbor negative views and sentiments about the country.

With its population and economy suffering under the strains of a socialist economic system, the Communist Party of Vietnam - the only political party permitted in the country - instituted a program of economic liberalizations and structural reforms in 1986. The program, referred to as *doi moi* (renovation) signaled the country was ready to move towards a market economy.

The cornerstone of the *doi moi* was an export-led economic growth strategy, a strategy that had already been pursued with reasonable success by the so-called "Asian

Tigers." Vietnam sought to position itself as a lower cost location than countries such as Taiwan, Hong Kong and Singapore for targeted manufacturing and assembly operations. Under the *doi moi* economic sectors and industries with potential for significant export growth were targeted and given preferential treatment in the forms of tax breaks and subsidies. Foreign investment was steered to the preferential sectors to provide the capital necessary to support expansion. Finally, Vietnam instituted a controlled, fixed exchange rate policy designed to maintain an undervalued currency in order to promote exports. While the country has moved towards a market economy, Vietnam still remains a communist country. The Propaganda and Training Department still controls newspapers, books, and even tourism companies to insure that the political ideology of the communist party is maintained.

Although the government of Vietnam is still communist, the economy has become more capitalistic. The government, however, still maintains significant control over the economy and operates many state-owned enterprises. The Propaganda and Training Department continues to control newspapers, books, and even tourism companies to ensure the political ideology of the communist party remains intact. Government bureaucracy and corruption are seen as impediments to further economic growth.

FDI AND ECONOMIC OPPORTUNITIES IN VIETNAM

In the late 1980s foreign investment began to flow into Vietnam as economic liberalization began to take shape. Lured by the prospects of cheap labor and untapped markets for consumer and industrial goods, foreign investors made their way to Vietnam in hopes of finding a new "Asian Tiger." The initial inflow of foreign capital was motivated by economic reform (doi moi) and the prospects of an underdeveloped market. Vietnam also benefited from a trend in FDI being directed towards emerging markets and increased intra-regional investment and trade in Southeast Asia. The enthusiasm for FDI in Vietnam, however, didn't last long, as communist bureaucracy and corruption began to make the country a less attractive market. Many early investors retreated from Vietnam and FDI peaked in 1996. The Asian financial crisis of 1997 further dampened foreign investor interest. Subsequent to the liberalization of the economy, Vietnam began to experience significant inflows of foreign direct investment and rapid economic growth. Real GDP expanded at a robust 9.00 percent annual rate from 1993 to 1997. Per capita income more than doubled, rising from about $810 in 1987 to roughly $1750 in 1997 **(Exhibit 2).** Many Western companies raced into Vietnam during this period due to its low labor costs, the preferential treatment provided by the government and the view that Vietnam was an untapped market for industrial and consumer goods. With the sudden drop in foreign investment in 1997, Vietnamese leaders knew a different direction in policy was needed.

Vietnam responded to the problems experienced by foreign investors and made some necessary changes. These changes re-affirmed its commitment to economic liberalization and international integration, and allowed it to become a member of the ASEAN Free Trade Area. In December, 2001 Vietnam signed a bilateral trade agreement with the United States and started the process of applying for membership in the World

Trade Organization. Once again, FDI has begun to make its way back into Vietnam. With rising labor costs in China, increased trade agreements with the United States and the EU, and the expected entry into the World Trade Organization (WTO), Vietnam attracted foreign investment at record rates. By the end of 2004, Vietnam had over 5,000 FDI projects, worth more than $46 billion. Vietnam attracted a record $1.3 billion in FDI in the first two months of 2006. Vietnam in 2005 attracted more FDI, as a percent of GDP, than China and appeared to have reversed the investment decline **(Exhibit 3)**.

Economic growth has also accelerated in Vietnam. After slowing to an annual growth rate of less than 7.00 percent from 1998 to 2004, real GDP advanced by about 8.00 percent in 2005. Per capita income reached $3,000. Moreover, there are a number of reasons to expect economic growth, per capita income and FDI to continue to expand in coming years. Factory workers in Vietnam earn on average $55 a month and are considered to be hardworking and dedicated employees. Vietnam has a young population, with two-thirds of its 84 million inhabitants in the prime working ages of 16 to 64. It has a literacy rate of 96%, and a growing middle class. English is favored as a second language providing an advantage to global commerce. Vietnam also offers lower production costs, not only due to low labor rates, but also because of additional lower operating costs including land, rents, and shipping expenses.

International investors consider Vietnam's political environment to be an increasingly stable one. Although Vietnam has a communist form of government, it has provided stability, unlike its neighbor Thailand which experienced a bloodless coup in September, 2006 and announced plans to put in place capital and foreign ownership controls. Vietnam has not suffered from the internal Islamic terrorist attacks which have occurred in Thailand and the Philippines. Vietnam also offers an attractive alternative to firms who seek to diversify their supply sources in the region. These and other factors have prompted A.T. Kearney, the international consulting firm, to rank Vietnam twentieth of the top twenty-five countries in its *2004 Offshore Location Attractiveness Index*. Kearney's index ranked Vietnam the second highest, trailing only India, in categories such as compensation costs, infrastructure costs, and tax and regulatory costs. However, Kearney's index placed Vietnam at the low range of the rankings in categories related to people skills and availability, and business environment. According to the Kearney Index Vietnam's attractiveness ranked it ahead of countries such as Russia, Spain and Ireland but behind countries such as Malaysia, Thailand and the Philippines **(Exhibit 4).**

The decision by Intel to invest in Vietnam is seen by some as confirmation that Vietnam has arrived as a major international player in the global sourcing game. Intel chose Vietnam over Thailand, the Philippines, Malaysia, and China mainly due to its low production costs. As Chairman Barrett stated, when responding to why Intel chose Vietnam, "Cost is always a driving force." Intel continues to operate manufacturing facilities in China, Malaysia, the Philippines, and Costa Rica. It appears likely that Intel will continue to invest in Vietnam. According to Barrett, "We consider this to be a small step in a long journey of involvement in Vietnam."

Intel is not the only large, multi-national technology company showing interest in Vietnam. Canon is building a manufacturing plant in Vietnam to produce ink jet printers and Fujitsu is already producing circuit boards for personal computers and telephones in the country. Nidec plans to build two plants to manufacture electronic components, and Sparton of Michigan, from the United States, makes chemical diagnostic equipment in Vietnam. Intel's facility will be located in the Saigon High Tech Park in Ho Chi Minh City, where a number of foreign software firms are currently operating.

CHALLENGES

While it appears that Vietnam may have a new day dawning for foreign investment, the country still has a number of difficulties that may make the future less certain. Vietnam remains a one-party communist country, and some of the problems that early investors experienced still are present. Although the country has become more capitalistic the government maintains significant control over the economy and operates many state-owned enterprises. Corruption and government bureaucracy continue to be problems, as well as a poor infrastructure, and restrictive laws concerning business operations. The region is also perhaps more vulnerable to an outbreak of the deadly H5N1 (bird flu) virus which is expected to cause economic turmoil, especially in countries ill-prepared for its arrival.

Vietnam imposes export taxes on some products and maintains high import tariffs on products that the government desires to be produced locally. Both export and import taxes have been reduced or eliminated in recent years, however, the government has a history of making policy changes quickly in order to achieve its objectives in international trade. The government maintains tight control over FDI, and this regulation is fragmented and sometimes ambiguous. Vietnam still is a developing country and its rule of law is considered weak by many observers. Vietnam ranks 99th out of 155 countries tracked by the World Bank in terms of the ease of doing business. Particular concerns include restrictions on hiring and firing employees, protection of foreign assets, and contract enforcement. The Fraser Institute, in its *Economic Freedom of the World, 2003* report ranked Vietnam 103rd of 127 countries – the lowest of all evaluated Southeast Asian nations except Myanmar. The Fraser Institute scored Vietnam low in areas related to the size of government, security of property rights, and access to sound money but considerably higher in categories dealing with freedom to trade internationally and regulation of credit, labor and business. Vietnam must continue to compete with other countries in the region in order to attract foreign investment. Compared to Thailand, for example, Vietnam is considered to be more corrupt, maintains more restrictions on foreign investment, and has a weaker rule of law and contract enforcement, a weaker currency, and a less desirable quality of life for expatriate managers.

DISCUSSION QUESTIONS:

1. Compare the attractiveness of Vietnam (as a host country for FDI) with other Southeast Asian nations. What factors make it more and less attractive compared to other Southeast Asian nations?
2. Do some types of FDI in Vietnam make more sense than others for international investors?
3. Case Exhibit 2 presents information on GDP in Vietnam measured by the Purchasing Power Parity method and also using the Official Exchange Rate. Using Purchasing Power Parity GDP is about $253 billion for 2005 while it is only about $45 billion when the Official Exchange Rate is used to measure GDP. What could account for such a wide disparity in the measure of GDP for Vietnam?

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EXHIBIT 1

MAP of VIETNAM

MAP OF SOUTHEAST ASIA

Source: Reproduced from CIA FACTBOOK

EXHIBIT 2

Demographic, Economic, Political Information for Vietnam, Cambodia, Singapore and Thailand

COUNTRY	Vietnam	Cambodia	Thailand	Singapore
CATEGORY				
Demographic				
Population (millions)	84.4	13.8	65	4.5
Growth Rate (%)	1.8	1.0	0.7	1.4
Male/Female (%)	59/41	49/51	50/50	50/50
Age Structure (%)				
0-14	27	36	22	16
15-64	67	61	70	76
.>65	3	6	8	8
Life Expectancy at birth (yrs.)	59	71	72	82
Labor				
Labor Force (millions)	45	7	36	2.4
Sector Employment (%)				
Agriculture	57	75	49	0
Industry	37	NA	14	36
Services	6	NA	37	64
Unemployment Rate	2.0	2.5	2.1	3.1
Literacy (% 15+ can read & write)	90	74	93	93
Economy				
GDP (USD billions)[1]	259	37	586	139
GDP (USD billions)	48.3	5.1	197	122
Growth Rate (%)	7.8	5.8	4.4	7.4
GDP per Capita (USD)	3,100	2,600	9,100	30,900
GDP by Sector (%)				
Agriculture	20	35	10	0
Industry	42	30	45	34
Services	38	35	29	66
Investment (% GDP)	33	19	29	22
Inflation Rate (%)	8	5	5	1

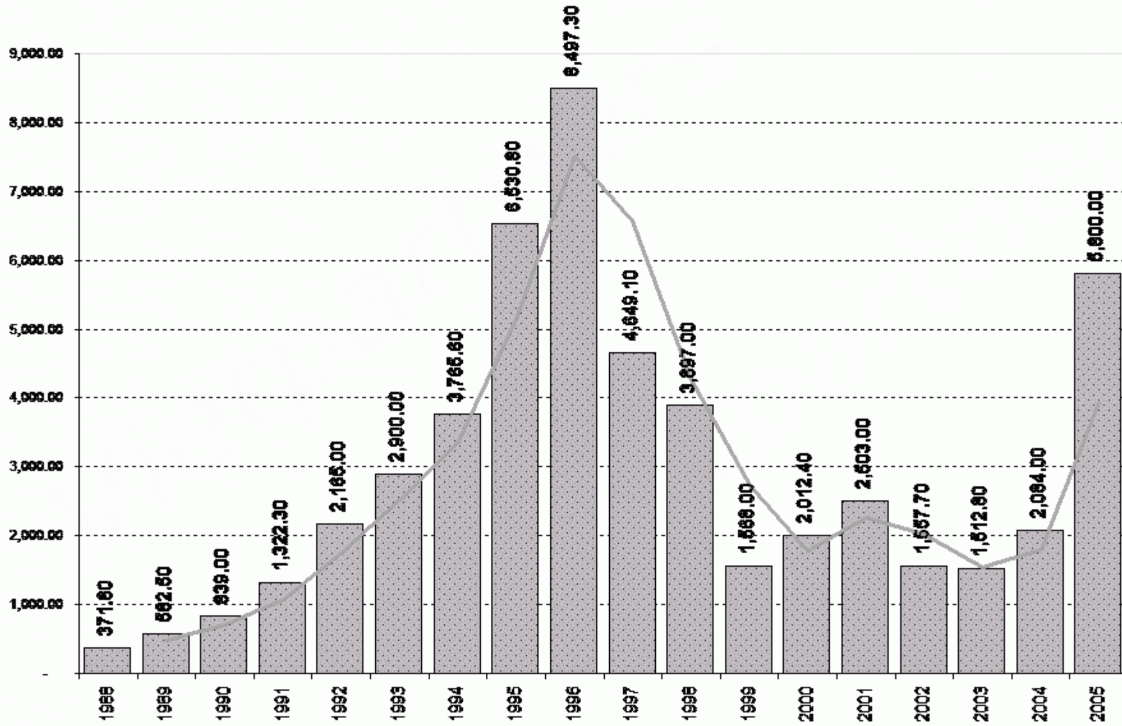
[1] The first measure of GDP uses the Purchasing Power Parity (PPP) method; the second measure uses the Official Exchange Rate. GDP per capita is based on PPP.

EXHIBIT 2, CONTINUED

COUNTRY	Vietnam	Cambodia	Thailand	Singapore
CATEGORY				
Political				
Government Type	Communist	Multiparty Democracy	Constitutional Monarchy	Parliamentary Republic
Legal System	Communist & French Civil Law	Civil Law	Civil Law	Based on English Common Law
Number Political Parties	1	4	5	4
Government Revenues (USD)	15.4 billion	.73 billion	40.3 billion	19.7 billion
Government Expenditures (USD)	16.6 billion	.93 billion	40.3 billion	19.9 billion
International Trade				
Currency	Dong	Riel	Baht	Singapore Dollar
Currency per USD (2006-2002)	16,037 – 15,280	4,119-3912	38.2-42.96	1.595-1.79
Exports (USD billions)	40	3.3	124	284
Imports (USD billions)	39	4.5	119	246
Major Exports	oil marine products rice coffee	clothing timber rubber rice	textiles footwear fishing products jewelry	machinery & equipment consumer goods chemicals mineral fuels
Export Partners	U.S. Japan China	U.S. Hong Kong Germany	U.S. Japan China	Malaysia U.S. Indonesia
Imports	machinery petroleum products fertilizers steel products	petroleum gold machinery motor vehicles	capital goods consumer goods fuels raw materials	machinery& equip. mineral fuels chemicals foodstuffs
Import Partners	China Singapore Taiwan	Hong Kong China France	Japan China U.S.	Malaysia U.S. China

Source: CIA World Fact Book

EXHIBIT 3
FDI Vietnam



Source: Vietpartners.com

Note: The numbers in the bars are index numbers. The weight distribution for the three categories is 40:30:30, meaning that financial structure is rated on a scale of 1 to 4 and that business environment and people skill and availability are on a scale of 1 to 3.

Source: A.T. Kearney

EXHIBIT 3

A.T. Kearney Offshore Location Attractiveness Index, 2004