



World Scientific News

An International Scientific Journal

WSN 128(2) (2019) 416-425

EISSN 2392-2192

Management of foreign investment inflows towards the sustainable economic development in Vietnam

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ABSTRACT

Vietnam is an FDI success story. Since the early economic reforms initiated 30 years ago under renovation policy or “Doi Moi”, FDI has become a major driver of Vietnam’s economic development. Competitive wages, stable political and economic environments, sound infrastructure, a favorable geographic location as well as a robust investment and trade policy framework have led to dramatic increases in FDI inflows. By any measure, the country’s FDI attraction achievements have been exceptional. In 2017, FDI into Vietnam exceeded inflows into other ASEAN countries, except Singapore. As a percentage of GDP, Vietnam’s FDI inflows already exceed those of China and India (and all large ASEAN countries, except Malaysia). The year 2018 also witnessed Vietnam post a record in FDI disbursement (US\$17.5 billion), against a backdrop of global declines in FDI flows during 2018 of 23 percent (Source: UNCTAD 2018).

Keywords: Vietnam, FDI, economic reforms, Doi Moi, sustainable economic development

1. INTRODUCTION

In thirty years of attracting FDI, Vietnam has achieved many important results. In the beginning, the FDI played the role of a “push” to create a breakthrough, providing vital resource to the development, stimulating internal resources to exploit the country’s potential and the

advantages, thus carrying the country out of the crisis. After only 10 years of “Doi Moi”, as a result of the FDI, GDP annual growth rate in Vietnam reached 8.2%, which laid a foundation for the socio-economic development in the following period.

2. MATERIAL AND METHODS

Over the last 30 years, FDI sector has been growing, becoming one of the most dynamic sectors of the economy. By the end 2018, there were 26,646 operating FDI projects, with a total registered capital of USD 334 billion, of which about USD 185.62 billion, equivalent to 55%, has been paid. These projects’ contribution to the country’s socio-economic development can be summarized in several keys as follows:

First of all, FDI is an important source of the total capital for the development of the whole society and has become a driving force of the economy’s growth. The share of FDI in total social investment increased from nearly 15% in 2005 to 23.7% in 2017, and in 2008 this proportion reached 30.8%

The contribution of FDI to the economic growth has been increasingly big. Its share in GDP increased from 6.3% in 1995 to 19.6% in 2018. The sector also contributed significantly to the State’s budget, with the contribution rising from USD 1.8 billion (1994 - 2000) to USD 14.2 billion (2001- 2010). In the 2011-2015 period, the budget collected from the FDI sector reached USD 23.7 billion, accounting for nearly 14% of the total budget; in 2018, nearly \$ 10 billion to the State’s budget, equivalent to 14.46%.

FDI has played an important role in promoting the economy’s restructuring. Currently, 58.2% of the FDI capital is concentrated in the processing and manufacturing industry, generating over 50% of industrial production value, leading to forming some key industries of the economy, such as telecommunications, oil and gas, electronics, information technology, etc., laying the foundation for long-term growth, as well as accelerating the modernization and industrialization of the country.

In addition, FDI has contributed to the development of high quality service industries such as banking and finance, insurance, auditing, law consultancy, shipping, logistics, education and training, healthcare, supermarkets, hotels, tourism, etc.; creating new ways of distributing goods and consumption, promoting domestic trade; shifting the agricultural structure, raising the value of agricultural products for export, creating a number of new production methods which has improved poor and outdated farming practices and infrastructure in some areas.

FDI has also affected the economic structure and speeded up the process of industrialization and modernization in some areas, contributing to the transformation of development space, new urban areas, industrial parks, processing zones and economic zones, thus changing the country’s image and contributing to the improvement of Vietnam’s seaport system, making the country one of the links in the global supply chain of the world’s leading maritime groups and seaport operators (Fig. 1-4).

Moreover, FDI has also contributed significantly to the promotion and expansion of export markets, there structuring of export commodities and step by step introduction of Vietnam into the global production network and value chain. The sector has carried out technology transfer in some industries and domains and have certain spillover effects on the domestic enterprise sector; promoting the development of supporting industries.

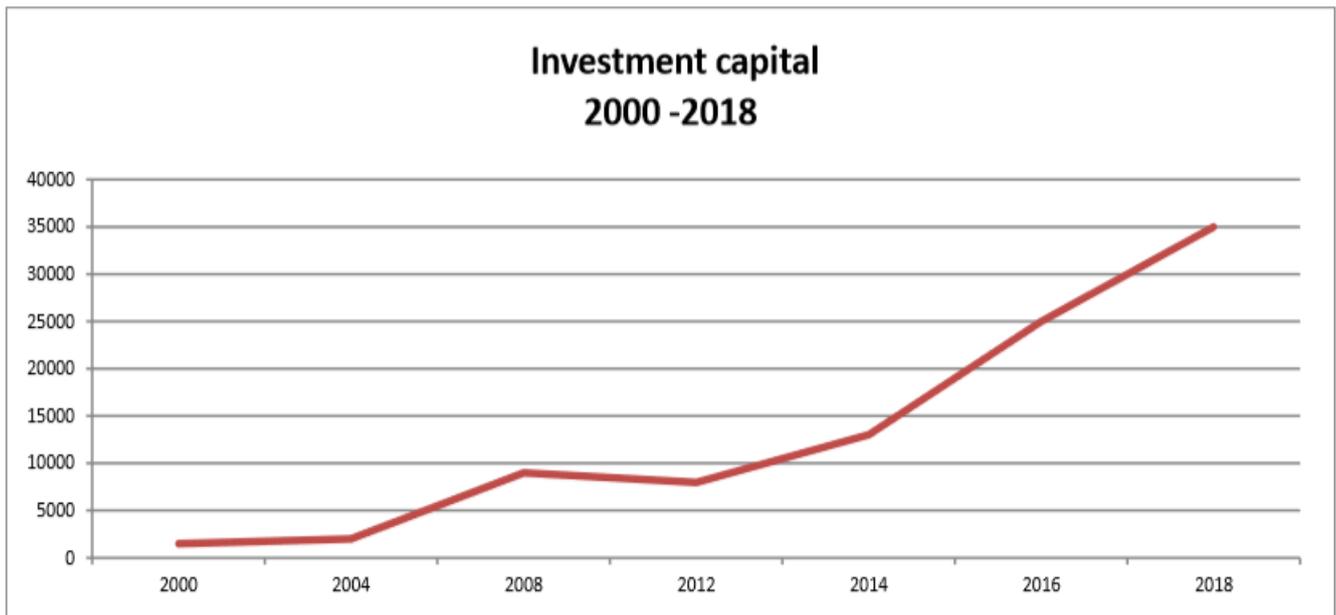


Figure 1. Vietnam is doing remarkably well in attracting foreign investment inflows Current US\$ million, 2000 -2018

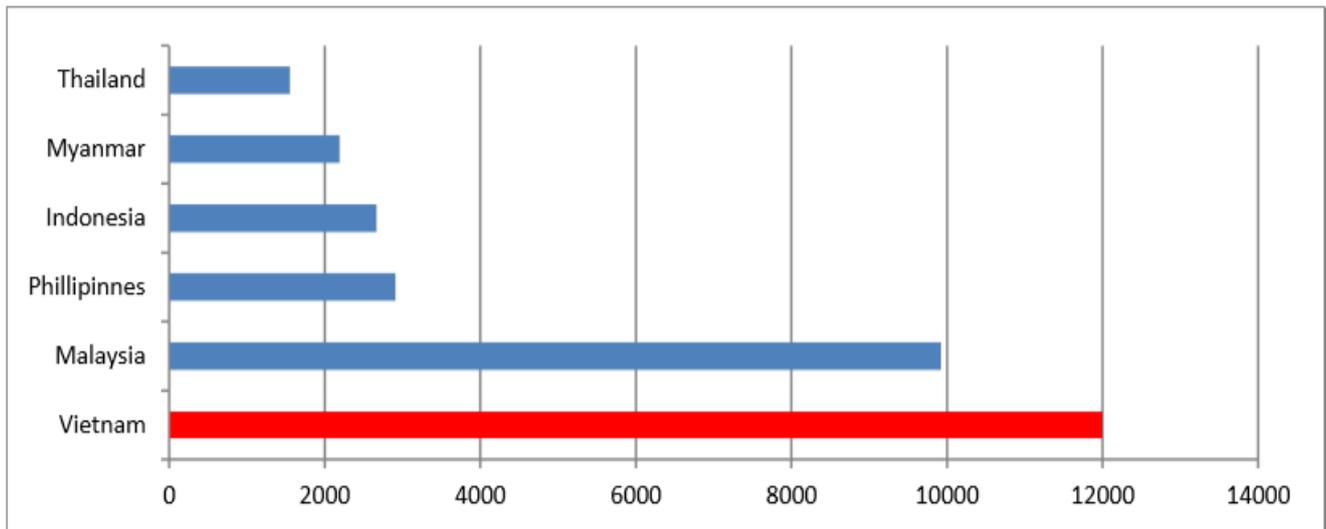


Figure 2. Vietnam, Thailand, Myanmar, Indonesia, Phillipinnes, Malaysia - foreign investment inflows Current US\$ million

Besides, the attraction and use of FDI over the past 30 years has contributed positively to the improvement of the economic and business investment environment in line with the principles of the market economy, increased the capacity of economic management and

corporate governance, supported the reform of state-owned enterprises, and enhanced the economy's competitiveness.

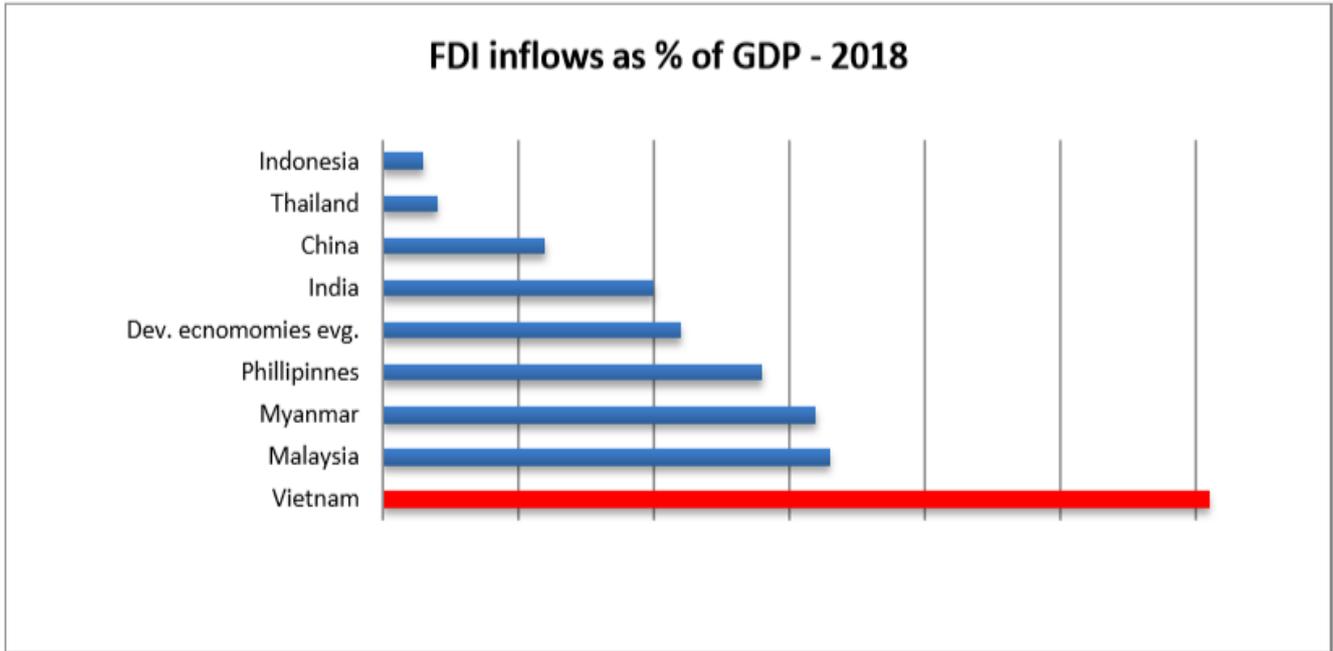


Figure 3. FDI inflows as % of GDP – 2018.

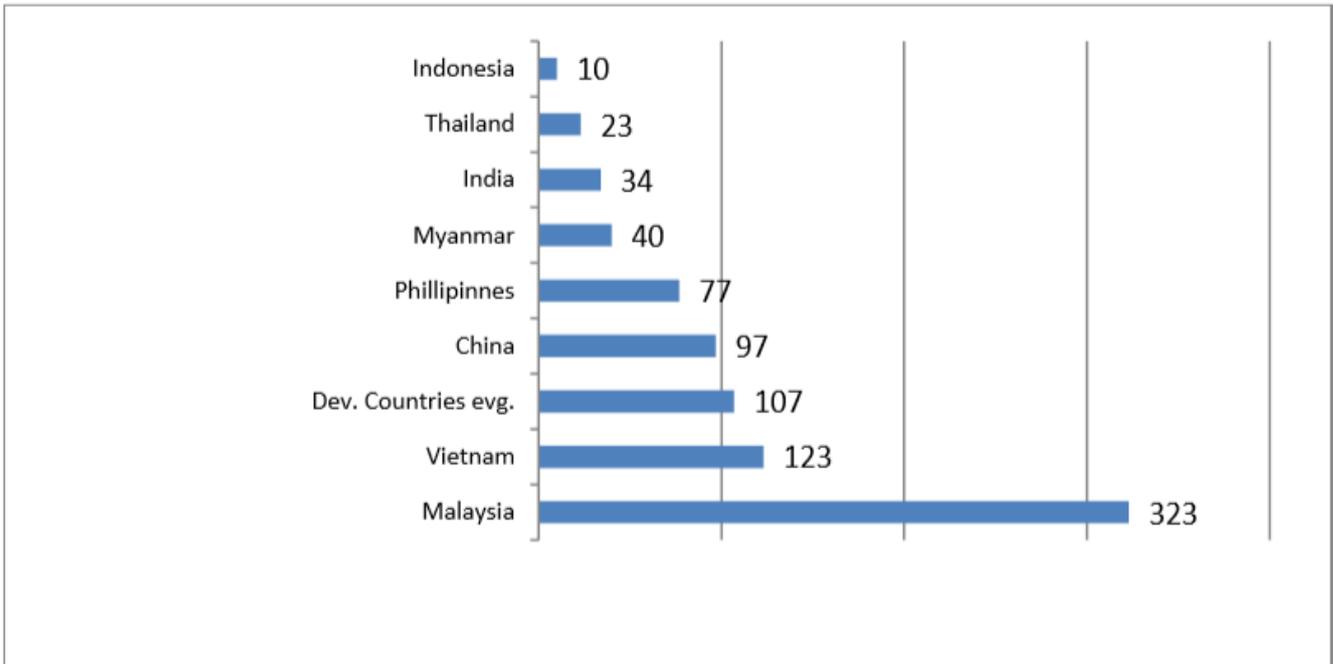


Figure 4. As a % of GDP or per capita, Vietnam's FDI inflows already exceeded those into China or India and most large ASEAN countries.

However, Vietnam is facing the most challenging issue of failing to make the most of or being unprepared to make the most of the benefits offered by foreign investments such as learning experience from other countries and integrating itself into the global economy to reach higher in the value scale. The economy is increasingly reliant on the FDI sector. It has been more than three decades and Vietnam has not well “learned” the FDI lesson. Though high expectations were placed on many FDI projects, they are still operating as “oases” which utilize the advantages of Vietnam’s economy for their own benefits while failing to create spill-over effects and form sectoral clusters with a high rate of localization and better global competitiveness. Vietnam is also facing the great challenges of environmental pollution and national security risks in attracting FDI. As foreign investors aim to maximize their investment returns, their money is only poured into places with competitiveness to gain profits. In this regard, Vietnam is an FDI destination. Regionally and globally, Vietnam has done very well in attracting FDI. During 1989-2018, the inward FDI in Vietnam totaled USD 159 billion, an equivalent to 58% of 2018 GDP, the second highest in the region.

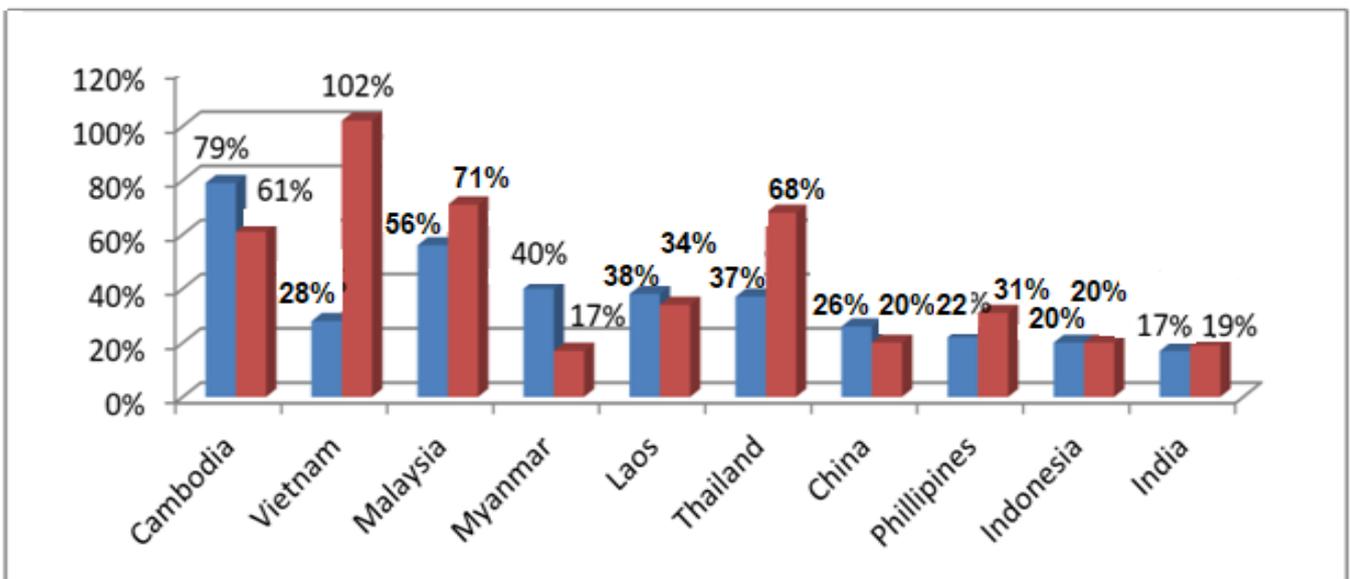


Figure 5. FDI during 1989-2018 in relation to 2018 GDP and export turnover in relation to 2017 GDP

FDI can be categorized into mining of resources, utilization of domestic market protection policies, on site export of services (tourism, real estate’s) and utilization of the economy’s competitive advantages. The first two categories of FDI often have larger roles to play in the beginning and do not offer significant benefits to an economy while the last two usually bring about positivity.

The data indicate that the FDI flowing into Vietnam for utilization of its advantages will be gone if the advantages are not utilized and this is very substantial as it is not just about FDI for mining of natural resources like other countries. In this regard, low-cost labor represents an extremely important factor. Frankly, if left unemployed, they are unable to create values for the society. These advantages will be gone if they are not utilized, which demonstrates how

significant FDI is. It is particularly important that FDI has contributed to a very high competitiveness of the Vietnamese economy, which is reflected in the proportion of export out of the GDP. In 2017, the figure reached 102% in Vietnam, the highest of the countries being compared. FDI has an especially important role to play in enhancing exports in particular and improving the economy's competitiveness in general. The proportions contributed by the domestic sector and FDI sector towards exports has reversed during the 1995-2016 period. In 1995, the domestic sector accounted for 73% of the total export turnover and the FDI sector for only 27%; in 2016 the figures have been 28.5% and 71.5% respectively. FDI-driven export surplus has increased with growing value over time. The FDI-driven export surplus helps balance the trade deficit created by the domestic sector and thereby supporting Vietnam's trade balance over years and Vietnam is now following the trend of trade surplus (Fig. 6).

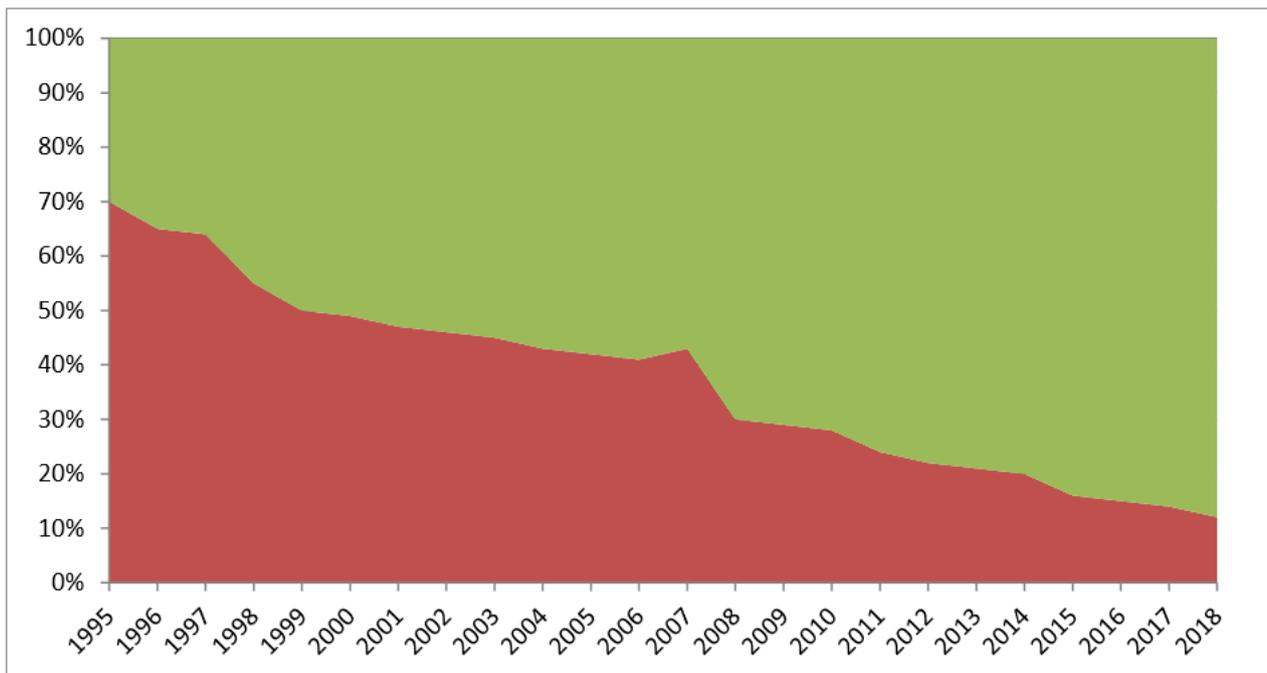


Figure 6. Export proportions of the trade surplus or deficit of the two sectors

It is also noticeable that FDI has contributed to multilateralism and diversify Vietnam's foreign relations with other countries. The fact that multiple investors from powerful economies in the world have heavily been involved in investment in Vietnam has ensured better security and strengthened global geopolitical relations despite potential risks associated with several FDI projects. These achievements are truly crucial.

3. EMERGING ISSUES AND CHALLENGES FOR MANAGEMENT OF FDI INFLOWS

On the perspective of Vietnam, the most challenging issue lies in the fact that almost all businesses or production sectors are acting as "oases" and FDI has not taken root or created

spillover effects and formed highly competitive sectoral clusters. In addition, local businesses are now in the early stage of development and have not been able to strengthen their footholds in the global markets. As a result, Vietnam has not been able to move further up in the value scale while facing increasing reliance on the FDI sector. There are seven issues and challenges as follows:

Firstly, the linkage between the FDI businesses in the textile and footwear industry and the local economy has not been close. After nearly three decades of involvement in the Vietnamese economy, FDI businesses are still largely involved in the processing stage and they are unable to move further up in the value scale. Compared to other sectors, local businesses in the textile and footwear industry have made considerable progress. However, FDI businesses and their local partners are seemingly playing on two separate fields without an organic linkage or connection through sectoral clusters.

Secondly, FDI businesses seem to dominate the assembly of electronic equipment or high-tech products. The leading global brands such as Canon, Intel, Samsung, etc. have been present in Vietnam and made enormous investments over the past decade. However, recent assessments reveal that the enabling factors for establishment of an electronics or high-tech sectoral cluster in Vietnam remain at a very early stage. The linkage between local businesses and these “alpha cranes” remains very poor.

Thirdly, several production and manufacturing sectors have received favorable policies such as sugar, automobile assembly and manufacturing for a long period of time but the outcomes delivered by FDI business have not met expectations. Several sectors were selected for red-carpet treatment but some of the foreign-invested businesses seem to only take advantage of the favorable treatment to sell their products at a higher price in the local market of Vietnam without placing emphasis on stages that offer additional added values in order to improve the competitiveness of the Vietnamese economy.

Fourthly, FDI inflows into real estate’s account for a large proportion and pose potential national security and defense risks. It is not unusual to witness the inflows of FDI into this sector. However, the related projects are often located in areas which are vulnerable in terms of the national security and defense. Moreover, real estate speculation has resulted in suspended planning and therefore led to social issues which should be well taken note of.

Fifthly, there are excessive incentives, policy inconsistency and competition among the local regions. It is often quite complicated to anticipate the related benefits and costs of incentives while at the same time Vietnam has to compete with other countries and therefore there may be cases in which excessive incentives were offered to investors. Additionally, the extended decision-making limit and fierce competition among provinces in this regard have encouraged FDI businesses to further break up their projects and relocate to enjoy incentives as a result of the race to the bottom at the local level. This issue requires genuine emphasis as Vietnam is the one who has to deal with its consequences.

Sixthly, transfer pricing or transfer of profits abroad has emerged as a huge challenge for Vietnam at present. How to cause foreign-invested businesses to publish their operating profits and thereby paying additional taxes in Vietnam remains an extremely nerve-racking question. Seventhly, there are potential security and environmental risks. Environmental disasters did happen and investment projects that pose national security and defense risks have been revealed. This represents challenging issues for Vietnam to tackle in order to mitigate unexpected impacts of FDI.

4. REASONS FOR FAILURE TO UNLEASH THE ADVANTAGES OF FDI

As discussed earlier, the failure to utilize the advantages of foreign investors with market linkages, excellent management capacity and abundant funding has been one of the most significant challenges for Vietnam. To put it bluntly, this represents an inherent issue for Vietnam and is further exacerbated by three major shortcomings namely education quality, innovation-based research and development capacity and copyrights and intellectual property.

Firstly, due to education shortcomings, there is insufficient skilled or proficient labor in Vietnam. In fact, Vietnam’s most important advantage over the past decades has been low-cost labor. However, this only works for processing or uncomplicated manufacturing sectors rather than the sectors that require skills and proficiency.

Secondly, as the research and development and innovation capacity is restricted, local businesses have failed to establish the linkages with or become providers of supporting products or services for FDI businesses, particularly when it comes to components or stages that require a high level of intelligence.

Thirdly, failure to safeguard the intellectual property rights has caused foreign-invested businesses unwilling to share and establish long-term relations or partnership with local businesses. This is a story told by a former senior executive of a corporation involved in assembly of high- tech equipment in Vietnam when the author conducted an assessment of the corporation.

Recommendation for next generation FDI - To attract the type of investment already defined above and which will be necessary throughout the upcoming period, several shifts in approach and policy are required as illustrated below (Table 1).

Table 1. Shifts needed in approach and policy to maximize value-added and spillovers from FDI.

Situation up to 2018	Next Generation FDI Strategy Targets
Investors’ primary motivations:	Investors’ primary motivations:
Low labor costs Low-cost utilities Risk-diversification alternative to China	High labor skills Resource-efficient technologies Superior location within ASEAN FTA
Investment Promotion:	Investment Promotion:
Reactive, cross-sector open-door “When investors come”	Proactive, targeted promotion “To attract the investors Vietnam wants”
Main marketing tool:	Main marketing tool:
Broad incentives to attract investors Based on short term cost advantages	Holistic sector strategies to attract investors Based on long term competitive advantages
Incentives focus:	Incentives focus:
Based on FDI \$-value	Performance-based incentives Based on local value-addition

IPA's/FIA's primary role:	IPA's/FIA's Reconstituted primary role:
Investment approval and monitoring	Investment promotion and facilitation along with outward FDI
Consequences:	Consequences:
Dual economy with little local content	High local value-addition

5. CONCLUSIONS

To put it fairly, attraction of foreign investments has been one of the highlights or most remarkable achievements of Vietnam since its Reform regardless of unexpected issues or outcomes. These achievements are associated with the opening and international integration successes in Vietnam. However, the most challenging issue facing Vietnam is how to make the most of or be prepared to make the most of the benefits offered by foreign investments such as experience learning, integration into the global economy in order to move further up in the value scale. In order to thoroughly utilize the advantages of FDI as well as improve the competitiveness and productivity of the economy, Vietnam should emphasize the three reasons for the foregoing challenges.

Firstly, to establish an education system, particularly tertiary education, that can deliver highly proficient and innovation- oriented human resources.

Secondly, to enhance research and development and innovation capacity. This solution is closely linked to the first issue, unanticipated consequences.

Thirdly, to ensure that the intellectual property rights are exercised and minimize the incidence of copyright and intellectual property infringement in Vietnam. Moreover, Vietnam is also confronting one of the extremely crucial issues, which is to control the race to the bottom at the local level in Vietnam.

Vietnam should consider adoption of a one-time incentive for FDI businesses operating in Vietnam rather than maintaining the current regime in which local authorities are authorized to offer repeated and separate incentives to FDI businesses.

As a matter of fact, Vietnam should also consider a scenario in which in the course of global competition, FDI businesses can relocate not only among local regions but also to other countries and this question is really challenging to deal with.

Finally, FDI achievements have been significant and the challenges it poses have also been enormous. In order to capture a comprehensive and objective view of FDI in relation to the policies that unleash the potentials and mitigate unexpected impacts, there is a need for Vietnam to separate attracting FDI from capitalizing on the opportunities it offers.

Without bias, regarding the former, Vietnam has been performing very well. However, Vietnam is facing various issues related to how to utilize the opportunities or unleash the advantages of FDI along with designing adequate responses to mitigate unexpected impacts. As the performance regarding the latter has not been substantial, the significance of the former has also been impaired.

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