

Did you know that Vietnam is becoming one of the major international hubs for manufacturing, while is already one of the biggest global exporters of mobile phones? Have you heard that the country was one of the world's poorest only 30 years ago, and is now considered more competitive than 6 countries of the European Union?

Vietnam has a very turbulent history, especially related to fighting off domination of outside powers. As the hostile period ended and Vietnam entered the era of peace during the last 3-4 decades, the country started working on its future. One of the major goals set by the government was to enhance and liberalize the economy. The first step in that direction was the launch of political and economic reforms, better known as "Doi Moi", in 1986. Looking from today's perspective, the reforms were largely successful, as Vietnam transformed from being one of the poorest countries in the world with per capita income as low as 100 USD, to current lower middle status, with per capita income of more than 2,000 USD.

## How it all happened?

The Doi Moi reforms were implemented gradually. The first main step was liberalization of agriculture, which enabled farmers to trade their produce on the market. This step ultimately increased the sector's overall productivity.

The second step followed in the beginning of 1990s, when non-agricultural sector liberalization process commenced. This action encouraged development of the private sector, and further boosted acceptance of market-based economy. Furthermore, Vietnam opened its borders to the world by initiating reforms that eased international trade and FDI.

As the Doi Moi reforms were implemented, three other main drivers of change were influencing economic growth over the last two decades, namely:

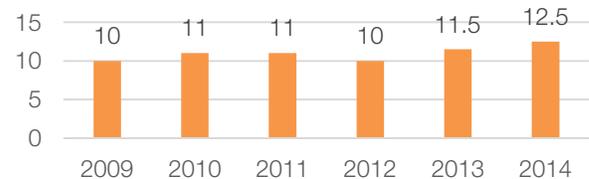
- Adding more people to the workforce (approximately 1 million per year);
- Urbanization, which led to productivity gains as people switched agriculture for urban jobs;
- Improvements in efficiency within different sectors, mainly influenced by technology and management practices brought in by foreign enterprises.

## Contemporary Vietnam: moving towards the higher value-added industries

Today, a very young population (65% of the population is younger than 40) of 90 million Vietnamese is seeing a fast development of their homeland. A full member of organizations such as the World Trade Organization (WTO) and the Association of Southeast Asian Nations (ASEAN), Vietnam experiences high GDP growth rates that averaged 6.4% per year since 2000. In 2015, the country grew at a rate of 6.7%.

Furthermore, Foreign Direct Investment (FDI) inflow is constantly strong. Since 2009, the implemented investment capital was not lower than at least 10 billion USD annually.

Image 1: FDI implemented capital, in billions of USD

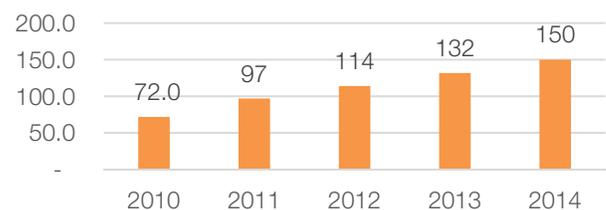


Source: General Statistics Office of Vietnam

It is important to note that investment in manufacturing is especially robust. Analyzing the data provided by the General Statistics Office of Vietnam, it can be seen that between 2009 and 2014 total investment inflows (by both public and private sector, domestic and foreign) in manufacturing grew at an average annual pace of 20%. In 2014, the total registered investment capital for manufacturing industry was close to 13 billion USD, higher than any other sector.

Finally, exports are constantly rising over the years, and are the major building block of the country's GDP.

Image 2: Total exports, in billions of USD

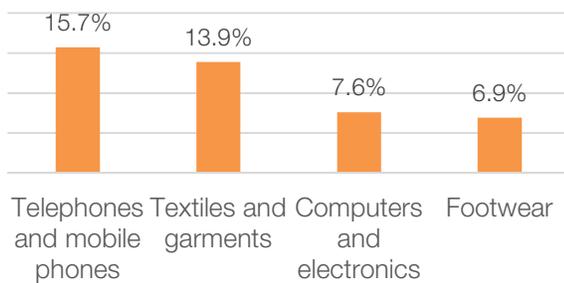


Source: General Statistics Office of Vietnam

The major export industries include higher value-added ones, such as mobile phones and computers and electronics, as well as more traditional, namely

garments and footwear. It can be seen that in 2015, exports from the higher value-added group grew faster (average 33%) compared to the traditional group's export expansion (average 12%). **Therefore, it can be argued that Vietnam is seeing a new trend where higher value-adding manufacturing is increasing its importance.** This is driven by international leaders such as Samsung, Intel and LG, who are strongly investing in manufacturing facilities across Vietnam.

Image 3: Vietnam's top 4 export sectors (2014)



Source: The Economist Intelligence Unit

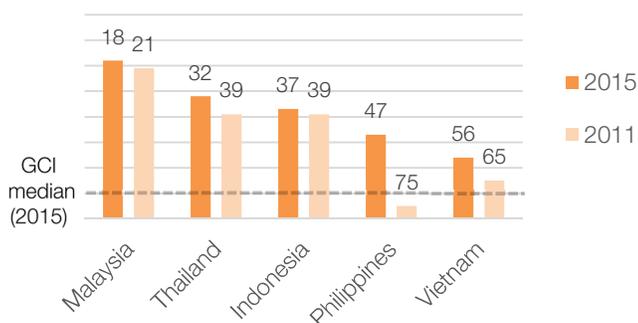
## Competitive outlook

The report by the World Economic Forum (WEF) argues that competitiveness, which is understood as higher productivity, presents a key driver of growth and resilience. This report analyzes countries' competitiveness based on 3 main groups of factors:

- a) Basic requirements
- b) Efficiency enhancers
- c) Innovation sophistication

Southeast Asia is showcasing its dynamism despite the global economy's slow development. Vietnam, along with Malaysia, Thailand, Indonesia and the Philippines, was steadily growing on the Global Competitiveness Index (GCI) list during the last five years, with all five countries ranking in the top half of the list (Image 4).

Image 4: GCI - Developing ASEAN (2011-2015)



Source: World Economic Forum

## Competitive Vietnam?

Progressing for the third year in a row, Vietnam reached the 56<sup>th</sup> position in 2015 on the GCI list, a jump of 12 positions compared to 2014. This impressive result presents the second highest increase among the countries placed on the top half of the GCI list, with India being the only country with a better result (jump of 16 positions). This growth can be prescribed to Vietnam developing most of its competitiveness factors, with especially strong results in infrastructure development and shrinking inflation, both belonging to the basic requirements group.

What is remarkable to see is that Vietnam tops 6 European Union countries on the GCI list. This result is even more notable knowing that 4 of them, namely Slovenia, Cyprus, Slovakia and Greece are regarded as advanced global economies, and have the GDP per capita of at least 17,700 USD, eight times more than Vietnam!

On the other hand, Vietnam had some disappointing results related to the efficiency enhancers group. The quality of higher education and training, technological readiness, financial market development and business sophistication were all ranked higher in other countries in the region such as Thailand, Indonesia and the Philippines. These factors, if not approached accordingly, can hamper future growth of country's competitiveness.

## The intimate relation: trade and competitiveness

There is no country that successfully managed to develop itself without opening its economy to international trade, investments and the movement of people. This three-fold integration influences the productivity and innovation of local enterprises due to stronger international competition, coupled with the pressure on government to devise more business-friendly policies.

The Vietnamese government understood the importance of opening its borders to trade and investments, and has worked on this topic for around two decades. Subsequently, Vietnam became a member of ASEAN in 1995, followed by signing the bilateral trade agreement with the US in 2000 and joining the WTO in 2007. In 2015, the country agreed to participate in three Free Trade Agreements (FTAs) with major global economies, namely:

- South Korea – Vietnam FTA
- EU – Vietnam FTA
- Trans Pacific Partnership

Furthermore, trade and competitiveness are essential components of Global Value Chains (GVCs), which are the key drivers of employment, productivity and growth in international trade. Production stages are nowadays spread across many factories and countries – a new paradigm compared to previous times. Developing countries can industrialize faster and more effectively by specializing in certain tasks and occupying niches of GVCs. This promise presents a great opportunity for all ASEAN countries, which are through the ASEAN Economic Community (AEC) already abolishing intra-regional trade tariffs. The AEC can therefore pave the road for ASEAN countries to become more important players in GVCs by working closely and performing specialized tasks based on each country's unique capabilities.

## What all of this means for Vietnam

Data shows that Vietnam is taking a confident approach to further develop its economy and strengthen its overall competitive position.

- The rise of FDI and exports is forecasted to continue, especially due to the new FTAs that Vietnam agreed to participate in. FTAs will also put pressure on policy creators to develop a more business-friendly environment.
- The stable GDP growth is translated into the evolvement of a middle class, which significantly increase the demand for domestic and foreign products in the upcoming years.

On the other hand, apart from the overwhelmingly positive trends, there are challenges that Vietnam has to tackle in order to continue its economic momentum, and to become a more efficiency-driven economy:

- Vietnam has to improve the quality of its higher education and training, as these two areas are the key factors for building competitiveness in the long run. Furthermore, with better education and training, employee productivity and technological readiness will also be positively affected.
- In the short to medium term, the country will have to improve its financial system. Here, the consolidation of the banking sector is needed, due to existence of too many banks in the market, as well as too many non-performing loans. Also, the interrelation between state-owned enterprises and the banking system will have to be reduced.

## BDG Insights

Vietnam is on its way to become one of the major manufacturing hubs of Southeast Asia due to its strategic location, number of signed FTAs, low costs and highly motivated labor. This is especially true for more sophisticated products such as electronics manufacturing, showcasing Vietnam's readiness to climb the value-added ladder.

Foreign investors, and particularly ones coming from Asia, have been proactively responding to this positive trend, which led to the rise of FDI. Consequently, competition for favorable manufacturing locations and qualified employees is increasing between foreign investors. This means that comprehensive knowledge of the country, its culture and its different locations with all advantages and disadvantages for different industries is required to make the right investment decision.

We at **BDG** are driven by the passion for Vietnam, and are devoted to help the country further develop its competitiveness. If you wish to join the bustling manufacturing sector, or have Vietnam in your strategic scope, we would be happy to help you through your new exciting journey!

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*Interested in new markets and trade opportunities in Vietnam?*

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