FDI, FTAs & GVCs behind Vietnam's superb export feat

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While theories about the gains from trade originated from the minds of thinkers and thought

leaders in Europe and North America, the practice of leveraging international trade to transform poor backward economies into prosperous and developed economies within a time frame of 50 years originated from the leaders and governments of East Asian countries.

East Asia led the way. First it was Korea, Taiwan, Hong Kong, Singapore, in the 1960s and 1970s. Then it was China in 1978 under Deng Xiaoping, who opened up a hard communist country for trade and foreign investment, calling it socialism with market orientation, giving China 30 years of 10 per cent plus growth.

Now it is the turn of another communist country, Vietnam, introducing Doi Moi reforms in 1984 which introduced another dose of trade and market orientation into a socialist economy.

The results are before us.

Vietnam has embraced export-led growth, a trade policy paradigm which originated in East Asia in the 1960s and 1970s, but with a 21st century twist.

What is new? The 21st century version that we see in Vietnam is export-led growth which is actually trade-led growth bolstered by three new distinctive features of modern international trade. These are: (1) unfettered foreign direct investment (FDI), (2) expansive regional and bilateral free trade agreements (FTAs), and (3) cross-border global value chain (GVC) integration.

Clearly, this is not export-led growth based on standard comparative advantage principles driven by local resource endowment. Much if not all of its export success, in manufactured products, is driven by foreign invested enterprises.

The government and local entrepreneurs in Vietnam welcomed foreign investment without reservations.

The thrust of Vietnam's trade policy is courting export-seeking FDI. Since the mid-2000s, the Vietnamese government has offered extremely competitive financial incentives to businesses seeking to set up operations in the country, in addition to a zero per cent withholding tax on

dividends remitted overseas and a low corporate income tax (CIT) rate of only 20 per cent.

To top it all, FDI regulations called for minimal local content requirement – a typical FDI inhibitor.

FDI in Vietnam has not only brought copious amounts of capital but created skill-based jobs, infused innovation, improved management, opened retail windows in developed country markets, upscaled to higher value added apparel (of man-made fiber) and electronic products, and so on.

But FDI came for exports not the domestic market.

Again, Vietnam has aggressively signed FTAs — most notably, RCEP, the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), EU-Vietnam FTA (EVFTA) plus a few more bilateral FTAs (e.g. Japan, Australia, New Zealand) Vietnam has attained near zero duty access covering 70 per cent of world Gross Domestic Product (GDP) and 50 per cent of world trade.

It is the combination of FDI and FTAs that makes Vietnam a competitor to be reckoned with over the long term.

Vietnam also courts GVCs. In apparel and electronics, Vietnam has pursued an overwhelmingly FDI route and GVC without regard to domestic value addition, receiving FDI inflows of US$28 billion (11 per cent of GDP) in 2020. The objective has always been to expand exports and capture world markets thus creating jobs at home. In apparel it imports 85-90 per cent of inputs (i.e. fabrics and accessories) and in case of electronics import share is even more.

Domestic value addition in exports is extremely low as evidenced by the fact that exports of $281 billion in 2019 exceeded Vietnam's GDP of $260 billion. That happens to highly trade-oriented economies (e.g. Singapore).

But anti-export bias prevails in Vietnam even with average tariffs of 6-7 per cent. What happens in Bangladesh with average protective tariffs of 27 per cent?

Vietnam’s local entrepreneurs are not focused on exports. It is the foreign-invested enterprises that dominate export activity. Not much different from Bangladeshi entrepreneurs outside the RMG sector.

The big policy questions for Bangladesh: Can we attract FDI in Bangladesh’s leading sector, RMG, without reservations? Can we sign FTAs with major regional markets or large economies? Current high tariffs are the major barrier.

Tariffs have to be slashed if FTA is the goal. To take advantage of GVCs, Bangladesh’s trade regime needs to be much more open with highly efficient customs administration to ensure seamless import[1]export of parts and components, i.e. intermediate goods.

The piece is slightly revised statement of Dr Zaidi Sattar, Chairman, Policy Research Institute of Bangladesh (PRI), at the webinar presentation of keynote paper, “Vietnam’s Superb Export Performance: Lessons for Bangladesh”, on 17 September, 2021.

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