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Attracting Foreign Direct Investment in Vietnam Towards Sustainability

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Abstract:

A gloomy economic picture, a decline in trade transactions, the potential destruction of global value chains, industries struggling due to the Covid-19 pandemic, lockdowns, and curfews in various parts of the world—this is what much of the media described about 2020. The Covid-19 pandemic, which began at the end of 2019 with unpredictable developments to this day, has been a shock to every aspect of the global economy. However, more importantly, the pandemic has contributed to accelerating the shift of international capital flows and reshaping global supply chains and value chains. With the vision of a developing country, Vietnam needs to seize the opportunity, strengthen its supporting industries, and create a healthy investment environment to maximize the opportunities brought by international capital flows, contributing to the rapid recovery of the economy in the post-Covid-19 period.

Keywords: Covid-19, capital flow shift, direct investment, indirect investment.

1. Introduction

The world has been, is, and will continue to face an unprecedented crisis caused by the Covid-19 pandemic. Covid-19 has affected every aspect of the economy, causing numerous difficulties and challenges in the recovery efforts of countries post-Covid. As of the end of 2020, global GDP had decreased by 5.6% compared to 2019, and growth in most regions presented a bleak outlook. The disruption of global supply chains has become a topic of significant discussion and debate among global economists due to its relation to international capital flows. It is evident that the Covid-19 pandemic has caused immediate and negative impacts on international capital flows, including both Foreign Direct Investment (FDI) and portfolio investment (indirect investment). The reactions of financial markets to the unpredictable developments of the pandemic and previous economic events have partially demonstrated its vulnerability. Therefore, understanding the changes in the components of these markets, especially the shift in international capital flows, as well as the causes and future trends, is essential for policymakers, central banks, and governments not only in developing and emerging economies but also in international financial centers to manage and stabilize global financial conditions.

2. Literature Review

The earliest explanation for Foreign Direct Investment (FDI) stems from the theory of capital flow, where FDI was initially viewed as part of portfolio investment. Hymer's (1960) groundbreaking contribution provided the first explanation of FDI within the industrial organization tradition. Hymer saw FDI as a means of transferring knowledge and other corporate assets to organize production abroad. Unlike portfolio investments, such transfers do not involve relinquishing ownership or control.

Similarly, Vernon (1966) used the product life cycle concept to hypothesize that companies transfer standardized and saturated production technologies from domestic markets to foreign ones. These two fundamental areas have led to many contributions explaining FDI and Multinational Enterprises (MNEs) from different theoretical perspectives.

While Caves (1971) and Dunning (1958) viewed FDI as a way to exploit ownership advantages, Rugman (1979) considered it a diversification of risk, with Kogut (1983) emphasizing it as an organizational asset and knowledge transfer. Furthermore, while Buckley and Casson (1976) and Hennart (1982) explained the logic for internalizing transactions within MNEs, Knickerbocker (1973) argued that MNEs exhibit a bandwagon effect, following competitors into new markets as a strategic response to oligopolistic competition.

The eclectic paradigm (Dunning, 1980, 1993) provides a framework based on Ownership, Location, and Internalization (OLI) advantages to analyze why and where MNEs invest abroad. Such investments may be resource-seeking (natural resources), market-seeking, efficiency-seeking, or strategic asset-seeking. The Uppsala model (Johanson & Vahlne, 1977) suggests that MNEs gradually increase their involvement in FDI. Initially, they make small investments in geographically and culturally close countries, but as experience accumulates, they make larger investments in more distant countries.

Subsequent theoretical developments explain the dynamic evolution of ownership advantages and how MNEs transfer them through FDI. These include resource-based approaches (Conner, 1991; Wernerfelt, 1984), evolutionary perspectives (Nelson & Winter, 1982; Teece et al., 1997), and organizational management approaches by Prahalad & Doz (1987), Bartlett & Ghoshal (1989), and Sethi & Guisinger (2002). The core of these theories is that a company's knowledge and skills constitute implicit ownership advantages. MNEs, with their ability to establish and manage complex organizational structures, maintain these advantages by leveraging them through worldwide investments.

Numerous empirical studies have focused on the determinants of FDI, particularly ownership advantages. Significant relationships have been found between FDI and technology (Lall, 1980), firm size (Li & Guisinger, 1992), capital size (Pugel, 1981), and product differentiation (Caves, 1971). However, these studies provide a general rationale for FDI without explaining regional differences.

The OLI framework suggests that market size, market growth, trade barriers, wages, production, transportation, and other costs, political stability, and government tax and trade regulations influence location decisions (Dunning, 1993). However, no study has simultaneously examined all these factors. The methodologies and focus of these studies also vary significantly. While Root & Ahmed (1978) investigated taxation and government policies using statutory corporate tax rates as a proxy for fiscal policy impacts on new investors, Nigh (1985) emphasized the positive impact of political stability, and Contractor (1991) examined the impact of government policies on FDI location choices.

Using the U.S. Department of Commerce's 1977 and 1982 Benchmark Surveys, Loree & Guisinger (1995) examined the impact of policy and non-policy variables on location. They found significant positive effects of investment incentives and negative effects of performance requirements and local tax rates. Non-policy variables such as political stability, cultural distance, per capita GDP, and infrastructure also significantly influenced FDI decisions.

Most of these studies are more relevant to initial market entry and do not flexibly analyze FDI trends. However, research on the investment development path (IDP) considers a longitudinal aspect (Dunning, 1981, 1986; Ozawa, 1992; Narula, 1996; Tolentino, 1992; Dunning & Narula, 1996). This perspective suggests that the type of FDI evolves with the host country's economic development stage. Less developed countries tend to attract resource-seeking and efficiency-seeking FDI in product markets or labor-intensive production tasks. As these countries grow and improve their economies, technological infrastructure, and workforce skills, they attract FDI in higher value-added activities.

3. Factors Influencing FDI Trends in Asia

3.1. Investment Location

Dunning's eclectic paradigm generally posits that an MNE invests in the most advantageous location. However, when examining the location decisions of various MNEs, "location" can have a broader regional meaning. MNEs often evaluate potential foreign direct investment (FDI) destinations on a regional basis rather than by individual countries. Geographically adjacent countries tend to share similar cultures, political systems, economies, and levels of development. Such countries often form regional economic groups with considerable uniformity in their trade and investment policies.

Operating in unified markets like these offers MNEs cumulative benefits, such as shared communication infrastructure, barrier-free intraregional trade, and networking opportunities. FDI into regions like Western Europe (EU), East Asia (ASEAN), South Asia (SAARC), Eastern Europe, Latin America (e.g., MERCOSUR), and Africa (PTA) follows a regional model to exploit the economic advantages of integration and the division of international labor mentioned earlier.

A report on "Japanese FDI Trends in Southeast Asia" by Prof. Yasuhiro Yamada from the East Asia Integration Research Institute (ASEAN-Japan) points out that Southeast Asia has been a global leader in sustainable economic growth over the past three decades due to strong reforms in the business environment and deep integration into the global economy. A specific example is Vietnam, where per capita income rose from USD 1,120 in 2009 to USD 1,990 in 2015. This income level is considered at the threshold of middle-income countries, with future projections of per capita income reaching around USD 12,745. In the coming years, ASEAN countries, especially Vietnam, will become attractive destinations for global investors thanks to their positive involvement in international economic integration and improvements in their business environment.

Through case studies in the project "Japanese FDI – Studies on Japanese Retailers in Asian Markets," Assoc. Prof. Atsuji Ohara of Nagasaki University (Japan) highlights Asia as a promising market for

Japanese investors, particularly with a new middle-class customer base in emerging markets. Japanese retailers are expanding their FDI from China to Southeast Asia as part of a diversification strategy, rather than solely focusing on the Chinese market.

3.2. Cost Pressure

Since the late 1980s, MNEs have made significant investments in major markets like China, India, and Indonesia. These countries traditionally maintained high tariffs to block foreign goods from entering their markets. Their governments allowed MNEs to access lucrative markets only when the MNEs established local production facilities.

As intense competition in the host region builds up, MNEs are compelled to invest in countries with low wages to reduce costs. In fact, in response to growing competition in Western Europe, U.S. MNEs shifted their FDI structures to Asian countries with lower GNPs (and thus less attractive markets) to leverage low wages. According to the United Nations Conference on Trade and Development (UNCTAD), China, South Korea, and especially Southeast Asia became ideal locations for such activities. Global FDI in 2013 totaled USD 1.45 trillion. While both the European Union and North America garnered only USD 250 billion each, Asia attracted USD 426 billion, accounting for nearly 30% of global FDI. Topping the list was China, which attracted USD 124 billion in FDI, excluding Hong Kong and Taiwan. This means that China alone received one-third of all foreign investment directed toward emerging economies in Asia.

3.3. Liberal Investment Environment

The efficiency and market-seeking FDI by MNEs in a region depend on whether the countries in that region implement investor-friendly liberalization policies.

Economic restrictions in most developing countries in Asia, Latin America, and Africa often stem from their socialist tendencies. Along with the greater benefits of investing in Western Europe, this has deterred significant FDI flows to Asia. However, the repeated failure of planned economies led to widespread dissatisfaction with restrictive policies, and gradually, these governments began opening their economies (UNCTAD, 1997). Between 1991 and 1996, more than 100 countries implemented a total of 599 changes to liberalize FDI regulations, and in 1997 alone, 76 countries introduced 151 liberalization changes (United Nations, 1998).

Instead of the previous hostility toward MNEs, governments have now established agencies to attract FDI. Thus, the dual pressures of intense competition in initial FDI destinations and the widespread liberalization of economies have worked in tandem to attract efficiency-seeking FDI into ASEAN countries (UNCTAD, 1997). The growth-boosting impact of FDI in this region has gradually compelled other developing nations to join the liberalization wave.

Malaysia has consistently maintained a liberal regime toward foreign investment. Especially in the late 1980s, after further liberalizing foreign investment policies, offering attractive incentives and facilities, and intensifying investment promotion efforts, FDI inflows into the manufacturing sector increased significantly. FDI contributed substantially not only to GDP growth but also to economic restructuring, transforming Malaysia from a primarily rudimentary manufacturing base to an industrialized economy.

China initially adopted a "gradual" opening-up policy, attracting FDI into a few Special Economic Zones (SEZs) as an experiment for implementing the Joint Venture Law from 1979 to 1985. After the success of four SEZs, the Chinese government encouraged more FDI, establishing 14 coastal open cities in 1984. The period from 1986 to 1991 marked stronger openness with currency market liberalization in 1985, the issuance of "State Council Regulations on Encouraging Foreign Investment" in 1986, and the "Law on Wholly Foreign-Owned Enterprises."

In 1992, China announced a continuation of its reform and opening-up policy, aiming to "build a socialist market-oriented economy." The government sought to extend FDI-friendly policies across the country. This phase saw the decentralization of power from central to local governments, allowing provinces and cities to freely develop investment incentive measures, resulting in thousands of Economic and Technological Development Zones being established, with significant increases in FDI. In 1997, to counter the effects of the Asian financial crisis, China liberalized its currency further to boost domestic demand, curb inflation, and continue attracting FDI. China’s entry into the WTO marked a gradual full opening of its economy.

The results of these economic reforms and opening-up policies have made China a leading FDI destination globally, contributing to higher industrial output, increased tax revenues, expanded exports, job creation, and absorption of technology and technical know-how. According to UNCTAD research, 400 of the world's 500 largest multinational companies have invested in China.

Vietnam is another prime example of opening its economy to FDI flows. Vietnam has a high degree of economic and trade openness. As a member of ASEAN, it benefits from the ASEAN Free Trade Area and the "ASEAN + 1" free trade agreements (including China, Japan, South Korea, Australia, New Zealand, India, etc.).

Vietnam has also joined the high-standard CPTPP and RCEP, which includes China, and has signed the Vietnam-EU Free Trade Agreement (EVFTA), a "next-generation Free Trade Agreement" with the EU, where tariffs on EU goods will gradually be reduced to zero. The U.S.-China trade war has caused tariffs between China and the U.S. to rise significantly, highlighting Vietnam's low tariff advantage.

Vietnam's liberalization measures are not only aimed at reducing trade costs but also at promoting domestic reforms, achieving high-quality openness, and creating a diverse and sustainable industrial chain. In terms of investment, Vietnam's political situation is stable, and the scope of permissible investment is broad. According to the 2019 FDI Restrictiveness Index compiled by the OECD, Vietnam is more open to foreign investment than China, ranking only behind Singapore and Myanmar within ASEAN.

3.4. Cultural Proximity

Many previous studies have found that cultural proximity to the host country is a significant determinant of FDI. However, some scholars argue that consumer preferences and tastes in different countries are converging toward a global standard, and thus the influence of cultural distance may gradually diminish. Moreover, MNEs may be forced to overlook larger cultural gaps in developing countries in favor of low wage advantages, choosing them as the “next best” locations.

As early as the 1950s, Japan began investing in Southeast Asia. Japan's direct investment in ASEAN countries has seen a strong and continuous increase. From 1990 to 1993, Japanese FDI in these countries rose from 7.8% to 11.33%. By 1994, the total investment had reached USD 5.13 billion. In 2014, this figure grew to USD 35.57 billion, equivalent to 12.5% of Japan's total overseas investment and 54% of Japan's direct investment in Asia. Following the Plaza Accord, the yen appreciated sharply against the U.S. dollar and ASEAN currencies, reducing the competitiveness of Japanese export products. This contributed to the trend of Japanese investment shifting to Asian countries, where the culture was similar, and production costs were significantly lower than in Japan.

In 2018, Japanese FDI in ASEAN reached nearly USD 30 billion, accounting for almost 56% of Japan's total FDI in Asia. Japan has also actively built strong economic ties with ASEAN in other ways. Between 2002 and 2008, Japan ratified economic cooperation agreements with all 10 ASEAN member countries. Japan also supports ASEAN's economic integration through cooperation within the framework of the East-West Economic Corridor, the Southern Economic Corridor (with ASEAN’s mainland countries), and the ASEAN Economic Corridor. These economic activities have helped boost Japan's influence in Southeast Asia.

In a 2019 public opinion poll, up to 93% of the ASEAN public viewed Japan as a friend, and 87% believed that Japan's role was crucial for the region. With these positive aspects, Japan-ASEAN relations will continue to thrive, further facilitating bilateral cooperation in the future.

3.5. Investment-Development Cycle

FDI into low-wage countries has also witnessed a mixed effect. As MNEs cannot afford to cede new markets to their competitors, they have had to follow them into these markets. As a result, increased economic activity has led to rising wages, and MNEs may begin to face intense competition even in new FDI regions. Eventually, the cycle of seeking new locations for efficiency- and market-seeking investments may repeat itself. Potential destinations must first meet prerequisites such as investor-friendly environments, political and economic stability, and good infrastructure, among other factors.

China's investment in Vietnam is currently efficiency-seeking, led by small and medium enterprises (SMEs). First, spontaneous investment by SMEs dominates. Chinese companies' investment in Vietnam is primarily private, with investments of less than USD 100 million, particularly in the textile industry with numerous SMEs. Second, the main consideration for investing in Vietnam is passive industrial transfer due to internal and external changes. Before 2017, American companies relocated to Vietnam mainly because of rising labor and land costs in China; after 2017, they shifted to Vietnam to avoid high tariffs resulting from the U.S.-China trade war.

Market-seeking investment also holds promise in Vietnam. According to China's historical experience, Vietnam is currently in a stage of economic development and industrialization that offers great opportunities for economic growth, rising incomes, and accelerated urbanization. Vietnam has a population of nearly 100 million people and a large total consumer market; its per capita GDP is equivalent to China's in 2006, and rising incomes are driving consumption upgrades; Vietnam's urbanization rate is only 36.6%, with much room for improvement compared to other middle-income countries.

Vietnam’s per capita GDP is less than USD 3,000, but in the context of the U.S.-China trade war and the COVID-19 pandemic, Vietnam has become a hotspot for foreign investment. The Japanese government spent USD 2.2 billion to support Japanese companies relocating their production facilities out of China with financial incentives. Half of the first 30 companies to relocate to Southeast Asia, announced in July, chose Vietnam. Then, the Vietnam-EU Free Trade Agreement (EVFTA) came into effect in August 2020. This high-level agreement will eliminate 99% of bilateral tariffs within 10 years. Moreover, South Korea’s electronics giant Samsung has moved all consumer electronics production out of China, with much of it relocated to Vietnam. Many Chinese manufacturers also see Vietnam as a preferred destination to avoid U.S. tariffs and shift production. Foreign investment in Vietnam is growing, reflecting a new landscape of cooperation and competition.

3.6. Political Stability

Political and social stability, along with the prospect of regional economic integration, are key drivers directing global capital flows toward Asia.

In Southeast Asia, total foreign direct investment (FDI) into the 10 ASEAN member countries in 2013 increased by 7%, according to UNCTAD. Singapore is regarded as the most attractive destination for FDI in the region, attracting USD 64 billion, significantly more than its neighboring countries Indonesia (USD 19 billion) and Malaysia (USD 22 billion).

In contrast, Thailand's political instability during the last six months of 2013 caused total FDI in the country to reach only USD 13 billion, falling short of the Thai government's expectations.

Similarly, countries like Thailand, Malaysia, and the Philippines are not ranked among the top 25 in the FDI Confidence Index due to political instability, poor economic performance, lack of skilled labor, and rising labor costs.

In stark contrast to Thailand's political deadlock, Myanmar has been undergoing a transformation since 2011. In 2013, according to the United Nations rankings, Myanmar achieved a remarkable success, recording USD 2.6 billion in FDI. For Vietnam, Laos, and Cambodia, UNCTAD assessments indicate that FDI inflows into these countries have remained stable and consistently grown, driven by political stability.

4. Global FDI Flows

When analyzing FDI flows across countries, different data sources are used based on the availability of updated figures. However, all FDI flows are recorded using the same methodology published in the OECD Benchmark Definition of Foreign Direct Investment (BMD4) and the IMF Balance of Payments Manual 6 (BPM6), which is the directional presentation method. This method is preferred for analyzing FDI flows by country, as it provides clearer insights into capital movements compared to the asset/liability approach, which doesn't clearly show the direction of capital flow. The differences in data among organizations arise from the timing of revisions, and UNCTAD's data have been adjusted accordingly.

Since the first waves of the pandemic, global organizations like the IMF, World Bank, and UNCTAD have predicted that global FDI flows, linked to supply chain shifts, could decrease. The data have proven these forecasts correct. Figure 1 clearly illustrates this trend for three groups: developed

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countries, developing countries, and transition economies, alongside the global changes.

In 2020, global FDI flows decreased by 42%, equivalent to USD 849 billion, compared to 2019 (USD 1.5 trillion). This marked the first time that global FDI fell below USD 1 trillion since 2005, a drop even steeper than the decline during the 2007-2008 financial crisis. This trend affected all groups of countries but to varying degrees. Specifically, FDI declined most sharply in developed countries, by nearly 70% compared to 2019, equivalent to about USD 229 billion. Meanwhile, developing countries also experienced a decline, though more modestly at around 12%. The impact of FDI inflows differs by region and depends on participation in global supply and value chains. To better understand the overall decline in each group or globally, we need to consider the countries that account for a significant portion of global FDI or that have a large influence on the global economy.

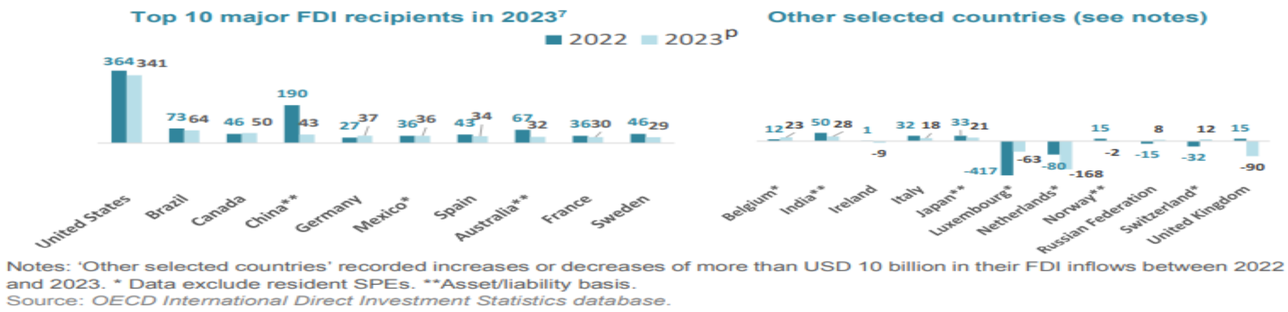

Figure 1: FDI inflows to selected countries, 2022-23 (USD billion)

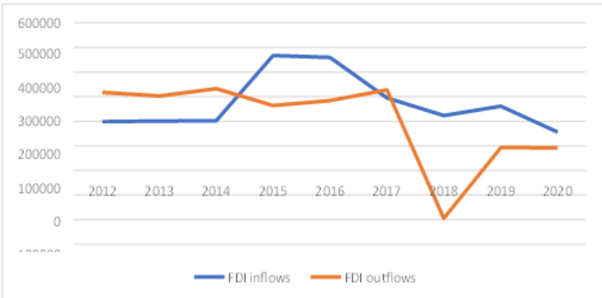

Figure 2: FDI into the U.S. and FDI from the U.S. abroad, 2012-2020 (USD billion)

Source: U.S. Bureau of Economic Analysis

As the world's largest economy, the United States is also a leading country in FDI activity. Therefore, changes in FDI flows to and from the U.S. need to be closely analyzed as they may help explain broader global trends.

First, FDI inflows into the U.S. decreased by more than 40% compared to 2019. Data from the U.S. Bureau of Economic Analysis (BEA) show that the decline mainly came from MNEs in countries with historically large investments in the U.S., such as Germany, Japan, and the UK (Figure 3). This can be attributed to the severe COVID-19 situation in the U.S., with rapidly increasing infection and death rates, as well as the impact of the U.S. presidential election at the end of the year. On the other hand, U.S. outbound FDI only slightly decreased, but the first half of 2020 was still more positive compared to the second half of 2019.

5. Current Status of FDI Attraction in Vietnam

Since implementing the Đổi Mới (Renovation) policy in 1986, Vietnam has attracted significant FDI inflows, becoming a rising star in the global manufacturing supply chain. While most initial investments flowed into low value-added sectors such as textiles and footwear, Vietnam quickly climbed the value chain, developing into a key electronics assembly hub. Despite intense trade challenges, Vietnam continues to lead in attracting high-quality FDI. Investment in the manufacturing sector accounted for 85% of total new FDI.

The goal for attracting FDI in 2023 emphasizes sustainable development, requiring a balanced approach that integrates economic growth with social welfare, environmental protection, and national sovereignty. By December 20, 2023, FDI inflows into Vietnam reached USD 36.61 billion, with disbursed capital amounting to USD 23.18 billion—an all-time high in the 2018-2023 period, representing a 32.1% increase year-on-year. This includes total registered new capital, adjusted capital, and capital contributions or share purchases by foreign investors. New registered capital increased to USD 20.19 billion, and the number of new projects grew by 3,188—remarkable figures. The number of new projects increased by 66.3%, significantly outpacing the growth of total new investment capital (which grew by 43.6%), indicating that small and medium-sized foreign investors remain confident in Vietnam's investment environment, prompting them to make new investment decisions. Although adjusted investment capital decreased, the downward trend showed improvement. New registered capital and capital contributions from share purchases increased, and the number of projects with capital adjustments also maintained growth, affirming investor confidence in Vietnam's investment environment and their continued decisions to expand existing projects.

In 2023, the most notable aspect was the sharp increase in new FDI inflows into the manufacturing sector, despite global economic difficulties and post-COVID-19 constraints. FDI continues to be a "tailwind" for Vietnam in the context of global supply chain diversification. Although there are existing challenges related to labor quality, Vietnam is still considered an attractive investment environment with many competitive advantages and favorable foreign investment policies.

Foreign investors have invested in 18 out of 21 national economic sectors, with the processing and manufacturing industries leading the way. These sectors attracted more than USD 23.5 billion in investment, accounting for 64.2% of total registered capital, a 39.9% increase year-on-year. This presents an opportunity for domestic enterprises to participate more deeply in the supply chains of large global corporations. Real estate came second, with total investment nearing USD 4.67 billion, accounting for 12.7% of total registered capital, a 4.8% increase year-on-year. The electricity production and distribution, finance, and banking sectors ranked third and fourth, with total registered capital of more than USD 2.37 billion (up 4.9%) and nearly USD 1.56 billion (a nearly 27-fold increase). Other sectors followed.

Regarding investment locations, foreign investment continued to concentrate in provinces and cities with competitive advantages, such as good infrastructure, a stable labor force, streamlined administrative procedures, and proactive investment promotion efforts. These locations include Ho Chi Minh City, Hai Phong, Quang Ninh, Bac Giang, Thai Binh, Hanoi, Bac Ninh, Nghe An, Binh

Duong, and Dong Nai. Together, these 10 localities accounted for 78.6% of new projects and 74.4% of total investment capital in the country in 2023.

In terms of the number of projects, Ho Chi Minh City led the country in new projects (38.2%), project adjustments (23%), and capital contributions or share purchases (66.3%), making it the top FDI destination with more than USD 5.85 billion in registered investment, accounting for nearly 16% of total registered capital, a 48.5% increase compared to the same period in 2022.

Quang Ninh surpassed several leading FDI hubs to rank third, attracting more than USD 3 billion in FDI.

As for investment partners, 111 countries and territories have invested in Vietnam, with Asian investors—Vietnam's traditional partners—holding a dominant share. Singapore, China, Japan, South Korea, Hong Kong, and Taiwan collectively accounted for 78.8% of total investment in Vietnam.

Singapore led with total investment exceeding USD 6.8 billion, representing 18.6% of total FDI, a 5.4% increase year-on-year. Japan ranked second with nearly USD 6.57 billion, accounting for more than 17.9% of total FDI, a 37.3% increase year-on-year. Hong Kong came third, with registered capital of over USD 4.68 billion, making up nearly 12.8% of total FDI, a 2.1-fold increase year-on-year. China, South Korea, and Taiwan followed in subsequent positions.

In 2023, China led in new projects (accounting for 22.2%), with Chinese investors focusing on Vietnam's consumer electronics sector. Two of Apple's three largest suppliers are investing in Vietnam. South Korea led in capital adjustments (25.9%) and capital contributions or share purchases (27.8%). One of South Korea's significant investments in 2023 was the USD 500 million ECOVANCE high-tech biodegradable materials plant in Hai Phong, the first such plant in Southeast Asia. Hai Phong also attracted four other projects: the expansion of Soft Industries' warehouse and tank construction project from Japan, with an additional USD 15.2 million; a new project by Hong Kong's Daimay Investment, worth USD 15 million, to manufacture auto parts; an expansion project by Thailand's Top Solvent Vietnam, with an additional USD 12.8 million; and a new USD 10 million project by Goodwe Singapore to produce optical equipment.

The U.S. had 1,286 active projects in Vietnam, with total registered capital of USD 11.7 billion, making it the 11th largest investor among 143 countries and territories investing in Vietnam. American investors have expressed a desire to become the top investor in Vietnam, particularly in high-tech and core technology sectors, where American companies lead globally. Vietnam's success in technology stems from Samsung's long-term FDI plan, which saw USD 18 billion invested between 2000 and 2020. Half of Samsung's global smartphone production now comes from Vietnam, encouraging other tech giants, including Apple, to expand their investments.

6. Factors Driving FDI Attraction in Vietnam

Several factors make Vietnam a favorable destination for foreign investors. These include:

First, a strategically advantageous geographic location for investment. Vietnam lies at the heart of Southeast Asia, a region home to major, dynamic economies. Its location provides easy access to global trade and acts as a gateway to economies on the western Indochina peninsula. Compared to competitors like India and Indonesia in attracting FDI, Vietnam has significant advantages, including proximity to

China, giving it direct access to over one billion consumers. Vietnam is also a key production base for Samsung smartphones and tablets. Moreover, Vietnam is part of ASEAN, a market of 650 million people, larger than the EU, with a GDP of nearly USD 4 trillion. Vietnam's political system is highly supportive of businesses, offering many incentives for large FDI projects. Additionally, its labor market, with a population of nearly 100 million (as of 2022), includes a rapidly growing middle class, creating a sizable consumer market that attracts foreign investors.

Vietnam's market is especially appealing to investors across various sectors, including real estate, consumer goods, automobiles, services, and infrastructure. Furthermore, Vietnam's free trade agreements (FTAs) with ASEAN, South Korea, Japan, Australia, and others, along with its membership in the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), provide Vietnam with competitive access to regional markets. Vietnam also benefits from being at the center of the fastest-growing region in the world, ASEAN.

Second, stable political, economic, and social conditions. Vietnam's political and social stability, along with streamlined administrative procedures and reduced informal costs, continue to attract foreign investors. Vietnam is known as one of the most dynamic economies globally, with over 90% of FDI enterprises rating these factors positively. Political and social stability has fostered strong investor confidence, encouraging investors to mobilize capital to increase investments and expand production. Infrastructure in industrial zones, export processing zones, and economic zones continues to be improved and upgraded. Vietnam's young population, rising income levels, clear foreign investment policies, and ongoing infrastructure development further bolster its attractiveness for FDI. The successful early control of the COVID-19 pandemic gave Vietnam an advantage over other countries. Vietnam remains a prime beneficiary of production shifts, thanks to its low labor costs, a large and relatively skilled workforce, and direct access to large markets like China and ASEAN.

Third, steady and increasingly positive economic growth. Vietnam's macroeconomic stability, controlled inflation, and balanced economic indicators have made it the third-largest economy in ASEAN, with a GDP of over USD 400 billion. International organizations recognize Vietnam as one of the most successful countries in attracting FDI. One notable success is VinFast, a domestic electric vehicle manufacturer, which has become the world's third-largest automaker by market capitalization, after Tesla and Toyota.

Vietnam's fintech startups, such as payment service providers Momo, ZaloPay, and VNPay, are growing dynamically, creating a vibrant startup ecosystem. Vietnam-Singapore Industrial Parks (VSIP), first established in 1996, have attracted USD 18.7 billion in investment and created jobs for 300,000 workers. Vietnam is advancing up the value chain from footwear and textiles to high-tech industries, including domestic fintech companies and startups.

Venture capital firms are also increasingly present in Vietnam, with growing interest from Western investors, including those from the U.S. Vietnam's positive medium- and long-term growth outlook, deeper integration into global value chains, and numerous FTAs in effect make it an attractive destination for FDI. Vietnam has solidified its position as one of the top investment destinations for European business leaders.

Fourth, efforts to improve the business environment and build investor confidence. Despite existing challenges in labor quality, Vietnam remains attractive with competitive advantages and favorable investment policies.

Labor costs in Vietnam (USD 329/month) are only a third of those in China (USD 1,119/month) and lower than in Malaysia (USD 862/month). Along with investment incentives, Vietnam's favorable investment environment continues to attract new investment projects and capital disbursements. Vietnam's primary investment incentives focus on three areas: (i) corporate income tax incentives, (ii) import-export tax incentives, and (iii) financial and land incentives. Vietnam has maintained positive FDI inflows despite global economic uncertainty, and the competitiveness of domestic supporting enterprises continues to help attract high-tech FDI projects from the U.S. While U.S. overseas investment typically amounts to USD 200-300 billion annually, FDI from the U.S. to Vietnam has averaged just over USD 1 billion per year.

Foreign investors trust Vietnam's government policies. Many foreign economic groups believe that Vietnam has significant potential to become a key player in global supply chains and to drive global trade. Investors are committed to expanding their investments in Vietnam in the coming years. Although challenges remain, Vietnam's innovative and forward-thinking approach is expected to unlock new opportunities and drive future cooperation and development, benefiting businesses investing in the country.

Vietnam is a favored destination for Japanese companies seeking to shift production to ASEAN, especially after Vietnam and Japan upgraded their relationship to a Comprehensive Strategic Partnership in November 2023. The U.S. is also strengthening its economic and technical ties with Vietnam after the two countries elevated their relationship to a Comprehensive Strategic Partnership in September 2023.

The most effective policies for attracting FDI include VAT exemptions and reductions, stable fuel pricing policies, improved labor permit and customs clearance procedures, and export-import policies. Vietnam's stable political and economic foundation, attractive investment incentives, abundant and well-trained labor force, and low manufacturing wages make it a prime destination for multinational companies. Many companies are implementing supply chain diversification strategies to reduce the risk of supply disruptions due to geopolitical conflicts. Vietnam is also a preferred destination for South Korean companies relocating production to ASEAN.

Fifth, effective use of advantages from FTAs. Vietnam's participation in 17 FTAs provides a strong foundation for attracting FDI. These include next-generation FTAs, such as the EU-Vietnam Free Trade Agreement (EVFTA), CPTPP, and Regional Comprehensive Economic Partnership (RCEP). These FTAs are creating a second wave of stronger integration for Vietnam, granting competitive access to free markets in 55 countries, including 15 G20 nations. This wave of FDI is expected to boost exports significantly. The EVFTA opens up opportunities for Vietnam to attract businesses from around the world, not just from Europe. Additionally, the EU-Vietnam Investment Protection Agreement (EVIPA) offers opportunities to attract FDI from both Europe and other countries seeking tax incentives.

Vietnam is targeting investment in sectors that align with its development goals, such as sustainability-focused, long-term investment projects. For instance, Canada is supporting the development of solar energy in Vietnam to promote clean technology. Vietnam’s growth continues to create opportunities for Canadian businesses in infrastructure, planning, and design, which require new materials, construction, and project management.

The UK-Vietnam Free Trade Agreement (UKVFTA), effective December 2020, is expected to boost exports to the UK and attract FDI into Vietnam’s competitive sectors. Vietnam’s numerous FTAs support medium-term growth prospects of 6-7% and the development of an advanced electronics ecosystem. Vietnam’s participation in next-generation FTAs, such as the EVFTA, CPTPP, RCEP, and UKVFTA, positions the country for deeper integration into global production networks and for selecting high-quality FDI projects, helping Vietnam move up the global value chain. The upgrade of Vietnam’s relationship with the U.S. (September 2023) and Japan (November 2023) to Comprehensive Strategic Partnerships is expected to usher in a new wave of investment into Vietnam. Successfully attracting FDI from the U.S. will yield dual benefits for Vietnam, enhancing both the quality of FDI inflows and the domestic labor force. Cooperation with U.S. businesses will also pressure domestic firms to advance in technology and management. Many major tech corporations are already exploring investment opportunities in Vietnam, reflecting foreign investors' confidence in Vietnam's growth prospects, investment environment, and economic position. Additionally, as a member of ASEAN, Vietnam has tariff-free access to 800 million people across Southeast Asia.

Challenges and Opportunities for Vietnam

Focusing on the U.S., China, and European countries in this analysis is justified as these are Vietnam's major trading partners, playing a crucial role in developing and maintaining its position in the global value chain and economic growth. Therefore, any changes in these countries will inevitably have some impact on Vietnam's economy.

In the bleak global economic landscape, Vietnam has emerged as a country that not only effectively controlled the pandemic but also achieved positive growth in 2020. This has contributed to making Vietnam an attractive destination for investors. However, are capital flows really shifting to Vietnam, and can Vietnam take advantage of this golden opportunity to elevate its position on the world economic map?

In recent years, Vietnam's active participation in the global supply chain has significantly contributed to its export growth. Import-export turnover has steadily increased over the years, playing an important role in Vietnam's GDP growth. Additionally, data from the General Statistics Office (GSO) shows that FDI inflows into Vietnam have been continuously rising, particularly after joining the WTO. FDI plays a pivotal role in Vietnam's import-export sector. For example, the manufacturing industry, a key driver of the Vietnamese economy, contributes over 70% of total export turnover, yet nearly 90% of exports in this sector come from FDI enterprises. This simple fact illustrates the critical importance of FDI to Vietnam's economy. In 2020 alone, foreign-invested enterprises accounted for 72.3% of export turnover and 64.3% of import turnover. The chart below shows that, similar to global trends, FDI inflows into Vietnam decreased by about 20% compared to 2019. However, compared to other countries such as Singapore (37%), Indonesia (24%), Thailand (50%), and Malaysia (68%), it is evident that Vietnam's efforts in pandemic control and investor confidence stabilization have been somewhat effective.

Amid the COVID-19 pandemic and the U.S.-China trade war, many have speculated that Vietnam could benefit from capital flows shifting out of China to countries like Vietnam and Bangladesh, especially in labor-intensive industries and technology giants. However, in reality, many global corporations are not yet ready to move out of China. Over 70% of U.S. companies in China do not have plans to exit but are exploring other markets to reduce dependency on China.

This suggests that Vietnam still has some time to prepare more thoroughly to seize the opportunities arising from FDI inflows. Preparation is necessary because, when observing the global value chain (GVCs), while Vietnam actively participates, most sectors are focused on the downstream. This means that companies still predominantly import input materials and semi-finished products from other countries for the production of export goods.

Vietnam's three most important export sectors—transport equipment, electronics and computers, and machinery and equipment—have been losing their position in the value chain. Despite strong participation in GVCs, the share of foreign-added value in total exports remains higher than the domestic-added value. Compared to other ASEAN, APEC, or Thai economies, Vietnam's domestic value-added share in key industries is low.

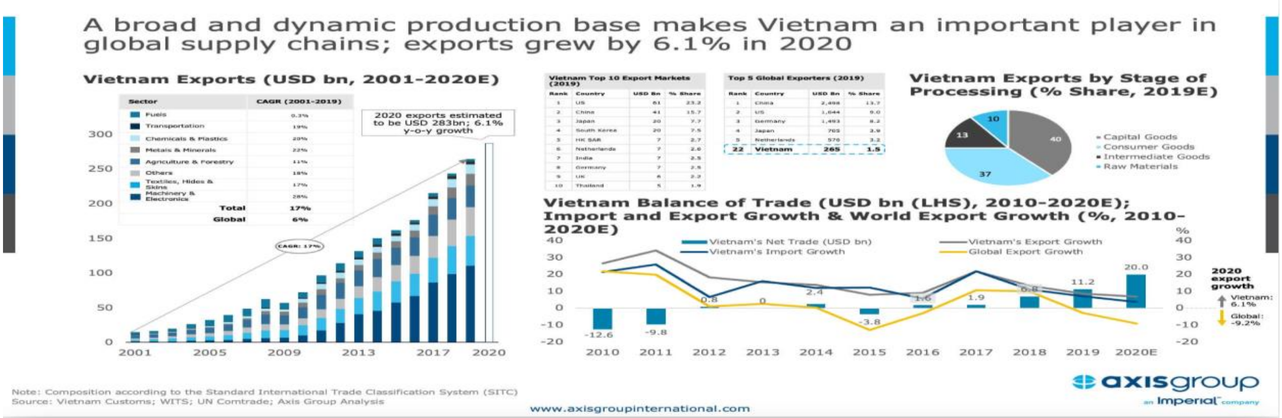

Figure 3: Position in the Global Value Chain of Nine Manufacturing Industries in Vietnam

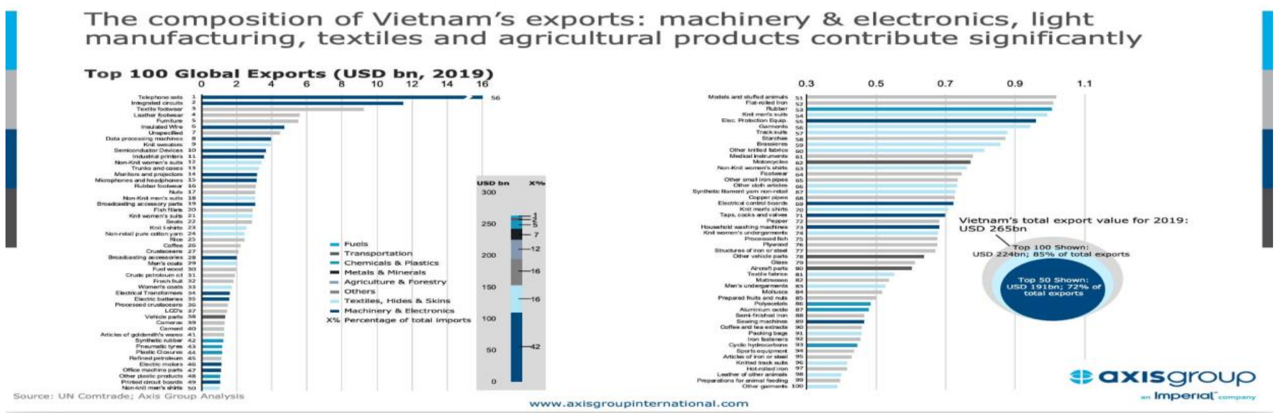

Figure 4: Share of Foreign Value-Added in Total Exports (% - FVA) of Nine Manufacturing Sectors in Vietnam

From the current state of FDI flows and the ability to participate in the value chain, Vietnam needs to make greater efforts to improve its domestic supporting industries, enhance the capacity of local manufacturers of semi-finished products, and better compete with foreign enterprises to become suppliers for FDI companies. Additionally, labor and environmental standards must be met to avoid situations like the recent one in China, where several major fashion brands declared they would no longer use cotton from Xinjiang.

Despite these challenges, there are positive signals for Vietnam's FDI attraction. According to The Economist Intelligence Unit's survey on the quality of the business environment, Vietnam scores more competitively than China in terms of FDI policies, foreign exchange controls, and labor market conditions. The reshaping of the supply chain is partly driven by rising labor costs in some countries like China, but supply chains still tend to shift to developing nations rather than developed ones. As a result, the shortening of supply chains post-COVID is increasing, but the appeal of outsourcing remains strong for multinational corporations (MNCs). Vietnam's labor costs remain highly competitive compared to other countries in the region. However, to elevate its position in the value chain, Vietnam should not only rely on cheap labor but also focus on developing a skilled workforce capable of performing more value-added tasks.

Conclusion

This analysis has highlighted the decline in both direct and indirect investment flows across most countries globally, driven by the impact of the COVID-19 pandemic and the uncertainties that continue to unfold. It also demonstrates that the shift in investment flows did not start with the pandemic but had already been underway in previous years due to various factors, such as U.S. and Chinese policies and the decreasing openness of global trade. Moreover, the global supply chain has been adapting to the unusual nature of the crisis caused by COVID-19. As Vietnam continues to develop its role in the global value chain, it faces significant opportunities to attract new FDI. However, the challenges, especially in building a robust supporting industry to fully leverage Vietnam's competitive advantages and increase value-added on the global value chain, remain daunting.

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