China-Vietnam Economic Activity

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1. Introduction

China and Vietnam are two of East Asia's most dynamic and two of the world's fastest growing economies. Economic ties between the two have become extremely important: China is the second largest importer of Vietnamese goods and the largest exporter of goods to Vietnam (dfat.Gov.au 2016). Bilateral trade between the two countries grew from $32 million in 1991 to $36 billion in 2011 (Amer 2014).

According to a 2015 story published in the Europe China Daily, a Vietnamese official claimed that bilateral trade between China and Vietnam had reached $66 billion in 2015, making China one of Vietnam's top trade partners (Europe.Chinadaily 2016). Within the Association of Southeast Asian Nations (ASEAN) Vietnam is China's number one trading partner (Clark 2016).

Vietnam's top exports to China include mainly electronic spare parts, agricultural and seafood products, and coal. Vietnam imports mostly machinery and equipment from China. In 2015, China was running 1,300 projects in Vietnam (Europe.Chinadaily 2016). Overall, Vietnam runs a trade deficit with China. (Clark 2016).

Both countries are nominally Communist but have undergone significant market-based economic reforms, which have driven their development from poor to middle income (Amer 2014). This paper will give a brief analysis of the Vietnamese economy and explain why it is so attractive to Chinese investors. It will also look at economic reforms in Vietnam, exploring how Vietnam's transformation from one of the poorest countries in the world to one of the fastest growing in many ways paralleled, and even mimicked, China's rise to wealth. And finally, the paper will examine some of the problems plaguing Chinese investment in Vietnam.

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2. The Vietnamese Economy Faced by Chinese Investors

The Socialist Republic of Vietnam (Vietnam) borders on China, Laos, Cambodia, the Gulf of Thailand and the South China Sea. Vietnam was a French colony from 1884 to 1954, when communist forces lead by Ho Chi Minh defeated the French and won Vietnam's independence. In 1973, Vietnam's war with the United States ended, and by 1975 the country was unified under a Marxist economic system (Worldfacts.us 2008).

Vietnam's economic and demographic fundamentals make the country an extremely attractive investment destination. The population is 91.6 million, with an average age of 27 (as compared to China's 37). According to the IMF, per capita income in Vietnam increased from $4.19 per month in 1980 to $150 in 2005. The current GDP per capita of $2,036, makes Vietnam a middle-income country. With a Gini coefficient of only 35.6 (as opposed to China's 42.1), Vietnam has the second most even wealth distribution in ASEAN after Indonesia. Less than 20% of the Vietnamese population lives in poverty, defined as living on less than $1 per day. The GDP growth rate is 6.7%, and unemployment is only 3.3% (Worldfacts.us 2008 and UNDP 2016).

The Wall Street Journal lists a number of reasons why Vietnam is an attractive investment destination -- the low level of existing capital stock means the production return on each dollar invested is large, a demographic shift which is increasing consumption, low wages, and a well-educated worked force. Literacy in Vietnam is 94%. Additionally, as the Vietnam government enacts reforms there is always the potential that a single act of government deregulation will unlock millions of dollars of business opportunity. Currently, only about 30% of Vietnam's population is urbanized, but the urban population is steadily growing. As the cities grow, so does consumption demand (Delfeld 2016).

A number of macroeconomic factors make Vietnam an appealing investment destination. With the exception of the 2008 global financial crisis, the GDP growth rate has held steadily between 6 and 7% since the year 2000. Over the last several years, foreign reserves have tripled. The interbank 3-month interest rate has dropped from a high of around 18% in 2008, to around 13% from 2010 to 2013, to a low today of around 4% (Trading.com 2016).

Vietnam is a country of young people, with an average age nationally of only 27, as opposed to China's 37. The median age in Vietnam is around 25, with 67% of the population being between 15 and 64, providing Vietnam with a large, young workforce who can contribute to GDP (Worldfacts.us 2008). Having so many young people means that Vietnam's labor pool will continue to grow. Young people are also the drivers of consumption, which in turn creates tertiary service sector jobs which help a country move up the value chain, increasing citizens' average income (Delfeld 2016). Vietnam has average births per female of 1.9, considerably higher than China's 1.66.

Consequently, while China's work force is shrinking, Vietnam's is growing at a rate of about 1.5 million per year (Worldfacts.us 2008).

Since the beginning of reforms, which moved Vietnam to a more market-driven economy, the country's rise has been dramatic. Vietnam's per capita GDP has increased from $100 per year in the 1980s to around $2,100 in 2015. At the same time, extreme poverty has dropped from about 50% in the early 1990s to 3% in 2012 (Focus-Economics 2016 and Gov.au 2016).

In order for developing countries such as China and Vietnam to become wealthier, they need to decrease agriculture as a percentage of GDP and increase first manufacturing, and then the service sector. Currently, 70% of the Vietnamese population still works in agriculture, but agriculture only counts for 17% of GDP. This means that the country's secondary and tertiary sectors are growing. Manufacturing accounts for 40% of GDP while the service sector accounts for 43% (dfat.Gov.au 2016).

Vietnam is a member of a number of international economic cooperative organizations such as The Association of Southeast Asian Nations ASEAN, Asia-Pacific Economic Cooperation (APEC), as well as the World Trade Organization. In 2017, Vietnam is scheduled to host the APEC summit (dfat.Gov.au 2016).

In 2002, China became the world's number one recipient of foreign direct investment (FDI). By 2015, China had become one of the largest sources of outbound direct investment (ODI) (Zhong 2015). According to Zhou and Leung (2015), 68% of China's 2015 ODI went to Asia. At the same time, Vietnam's outstanding economic fundamentals have made the country a major recipient of FDI. Vietnam's received FDI has increased from $70,000 in 1970 to $11.8 billion in 2015 (Data.Worldbank 2015). FDI in Vietnam has also been increasing, at least partly, because of Vietnam's proximity to the Chinese border (Hunt 2016)—the world is beginning to invest in Vietnam as a gateway to China. And China is investing in Vietnam as a gateway to ASEAN. In fact, in 2016, China's ODI in Vietnam reached $56 billion, distributed among 5,000 projects (Duong 2016)

Apart from Vietnam's excellent economic fundamentals, the country is an attractive destination for Chinese investment because of its low manufacturing wages. The country's minimum wage varies geographically, from between $90 and $129 USD per month, which is about a quarter of the average wage in China (U.S. Department of State 2014 and Kuo 2014).

Many national laws governing foreign investment also make the country attractive. Vietnam's investment law allows for wholly owned foreign firms in the country. This includes banks, which are permitted to be up to 100% foreign owned, although foreign banks are only permitted to purchased up to 20% of a local bank. The development of nearly every industry in Vietnam is government by a government five-to-ten-year

Master Plan, to which most FDI projects must conform. The government encourages investment in "high-technology, agriculture, labor-intensive industries (employing 5,000 or more employees), infrastructure development, and projects located in remote and mountainous areas." Sectors prohibited from foreign investment include those “detrimental to national defense, security and public interest, health, or historical and cultural values” (U.S. Department of State 2014).

Certain sectors are listed as having conditional foreign investment, including national defense, "security, social order and safety; culture, information, press and publishing; finance and banking; public health; entertainment services; real estate; survey, prospecting, exploration and exploitation of natural resources; ecology and the environment; and education and training" (U.S. Department of State 2014).

3. Vietnam Follows China’s Economic Reforms

Vietnam’s move to “market socialism” is very similar to China’s transition to “socialism with Chinese characteristics.

The People’s Republic of China was founded in 1949, when a rigid, centrally planned, Marxist economic system was implemented, modeled on the Soviet style. Nearly all companies were state owned enterprises (SOE) and China engaged in very little, if any, inbound or outbound foreign investment. GDP figures for the years 1949-1978 made China one of the poorest countries in the world. In 1978, under the leadership of Deng Xiaoping, the country enacted numerous economic reforms, moving toward a system dubbed “Socialism with Chinese Characteristics”. Over the past nearly four decades, since the reforms began, private enterprise was first tolerated, then later encouraged, as was private ownership. Many SOEs were first corporatized, then privatized. FDI was encouraged. The stock market was reopened and even SOEs went public. Eventually the reforms created so much prosperity that China became the world’s leading recipient of FDI and is now a leader in ODI as well (News.BBC 2006).

Similarly, Vietnam also moved from a fully planned to a partially planned economy. The transition happened ten years behind China’s, and with the benefit of having a China model to follow.

With the end of the American War in Vietnam, in 1975, the north and the south were reunited under the Communist leadership of a Hanoi government, which instituted a tightly controlled socialist economic system. From 1976 until the beginning of doi moi (renovation), in 1986, the country suffered food shortages. With ~~After~~ doi moi Vietnam officially changed to “market socialism” or “socialist oriented market economy.” This new system included a partially planned economy combined with free market incentives. By 1990, 30,000 private businesses had been created. And the country experienced a GDP growth rate of 7% per year. In 2001, the Vietnamese communist party officially recognized the private sector, while maintaining the controlling position of the public sector. Meanwhile, many SOEs were reduced in size or privatized, as was done in China (The World Bank 2016 and U.S. Department of State 2014).

The fact that the nation's currency, the Dong, is non-convertible actually protected Vietnam from the 1997 Asian financial crisis. At that time the government still maintained a number of SOE and controlled key sectors, such as banking, just as China has done (The World Bank 2016 and U.S. Department of State 2014).

By 2003, the private sector accounted for a quarter of total GDP. In spite of Vietnam's fast-paced growth and market reforms, World Economic Forum's 2005 Global Competitiveness Report ranked Vietnam well behind China. The poor ranking is attributable to a lack of faith in the functioning of government institutions in Vietnam as well as widespread corruption and a lack of property rights, and the inefficient regulation of markets. According to Trading.com (2016) Vietnam had an ease of doing business ranking of 99 in 2013 (the lower the number, the better). By 2016, this score had improved to 82, but Vietnam still has a long way to go. Financial market reform is also needed as the financial sector is still dominated by state owned banks, which are holding large numbers of non-performing loans.

Another area where Vietnam has followed China's lead is in the realm of private property legislation. China enacted a number of private property and private enterprise laws through the 1990s, culminating in the 2007 private property law (The Economist 2007). Vietnam enacted its private property law in 2013 (U.S. Department of State 2014).

SOEs have decreased in importance and size in both countries. By 2012, SOEs only accounted for 32% of Vietnam's GDP, while SOE employment dropped to 10%. However, SOEs still dominate strategic sectors such as oil and gas, telecommunications, electricity, mining, and banking (U.S. Department of State 2014). China also maintains a number of SOE-dominated sectors, in spite of decades of economic reforms. Consequently, China's largest banks are all state owned: the Bank of China (BOC), the China Construction Bank (CCB), the Agricultural Bank of China (ABC), and the Industrial and Commercial Bank of China (ICBC). Three of Vietnams largest banks are also state owned: VietinBank, Bank for Investment and Development of Vietnam (BIDV), and Vietcombank.

China enacted its first five-year plan under the leadership of Chairman Mao Zedong in 1953. Since then, successive Chinese leaders have lead the country in accordance with five-year plans (C N Trueman 2015). Vietnam also uses five-year plans. Similar to China, Vietnam's five-year plans set a desired level of GDP growth and often suggest how this growth will be reached, and which economic sectors are meant to lead (Vu 2015).

Some of Vietnam's economic problems are similar to those of China, such as a large state sector plagued by over-sized and inefficient state-owned enterprises, with P/E ratios of 7.8 To put this number in perspective, compare Vietnam with two of southeast Asia's other large economies, Indonesia where P/E ratios are 26.9 and the Philippines where they are 21.3. "The Vietnam market index trades at just 1.1 times book value with a dividend yield of 6.3%" (Delfied 2016). Meanwhile, Indonesia trades at 2.4 times book value and the Philippines at 2.6 (Delfeld 2016). Additionally, the state-owned banking sector is sitting on heaps of non-performing loans. According to Talkvietnam (2016) 6 of 17 banks in Ho Chi Minh City are trying to reduce their non-performing loans by 22% of their portfolios. To cope with these loans, Vietnam has consolidated a number of its banks, increasing the asset base and reducing the ratio of non-performing loans. "the ratio of non-performing loans (NPLs) to total banking assets has been reduced from 17.21 per cent in September 2012 to 3.72 per cent at the end of June 2015" (Suiwah 2016).

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4. The Vietnam Stock Exchanges

During the early years of the People's Republic, China had closed down its stock exchanges. In 1990, the Shanghai Stock Exchange reopened as the primary stock exchange of the People's Republic of China. In 1991, the Shenzhen Stock Exchange opened. Vietnam, which often follows China's lead in economic reforms, established State Securities Commission in 1997 to regulate the country's securities markets. The physical stock exchange, called the Ho Chi Minh City Securities Trading Center, executed the first trading session on July 28th 2000, with only two listed stocks. In 2007, the Ho Chi Minh City Securities Trading Center was converted to the Hochiminh Stock Exchange (HOSE or HSX). The exchange trades Monday through Friday, from 9:00 to 14:45. The exchange has 307 listed companies, mostly large cap, with domestic market capitalization of $51,019 million USD. The benchmark for the HOSe is the VN-Index.

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The Hanoi Stock Exchange (HNX), was opened in 2005 and trades mostly small and medium cap OTC stocks (Maresca 2012). HNX has 380 companies with a total market capitalization of $7.019 million USD. Rather than being self-regulated, the two exchanges are still under the management of Ministry of Finance and State Securities Commission. Companies are not permitted to cross-list. Short selling is allowed, but margin trading is not. Foreign ownership limits (FOL) are set at "49% for listed companies, except banks, which are 30%. Foreign investors are allowed to own 100% of Securities companies" (Sustainable-Stock-Exchange 2016).

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The Ho Chi Minh VSE is a stock market index which tracks 303 equities listed on the two exchanges.

5. Chinese Investment in Vietnam

In December 1987, the Vietnam National Assembly passed a law allowing foreign investment (Nguyen 2015). In 1991, China normalized relations with Vietnam and Chinese FDI began in that same year (Amer 2014 and Nguyen 2015)-- a firm from Guangxi invested in a joint venture to open a restaurant in Hanoi (Nguyen 2015).

Do Tien Sam, editor in chief of the China Research Journal, told Xinhua news that a stable political situation between the two countries has increased private Chinese investment in Vietnam (Nguyen et. al, 2014). Most likely because of a combination of political stability and sound economic fundamentals in Vietnam. Chinese investment in Vietnam increased from just 71 million U.S. dollars in 2012 to 2.3 billion U.S. dollars in 2013, with 89 new projects and money added to existing 11 projects, (Nguyen et. al, 2014).

Since 1987, Chinese investment has risen steadily, peaking in 2013. Geographically, Chinese FDI is focused on Hanoi, Ho Chi Minh City, Binh Duong, Bac Ninh, and Hai Phong. Chinese FDI has flown into projects ranging from processing agriculture, fisheries, manufacturing, steel, real estate, construction, textiles, appliances, fertilizers, building materials, fodder to mining. Of the 17 sectors of the Vietnamese economy China invests in, real-estate and textiles are the primary concentration. China has also engaged in building infrastructure and capacity expanding projects in Vietnam, such as coal fired power plants. (Nguyen 2015).

Vietnam is badly in need of infrastructure development. "World Economic Forum Global Competitiveness Report, Vietnam ranks 99th out of 140 in terms of overall quality of infrastructure, 93rd in quality of roads, and 76th in quality of port infrastructure." (Vietnam Briefing 2016). The 120-MW An Khanh–I thermoelectric Plant in northern Vietnam was one of four such projects built by Chinese contractors. (Xinhua, 2015)

China's investment in Vietnam’s garment industry is also drawing infrastructure investment in the form of industry capacity expansion. For example, the Chinese garment and textile giant Jiangsu Julun Textiles Group Co. Ltd is set to invest $68 million in a manufacturing facility in the Bao Minh Industrial Park. A Hong Kong company, Luenthai, is involved in a joint venture with the Vietnam National Textile and Garment Group (Vinatex) and China’s Sanshui Jialida Textile Company to construct a garment manufacturing facility in the industrial park (IP) (English.Vietnam.vn 2014).

Additionally, China invests in raw materials such as rubber, fossil fuel and coal production facilities, as well as wood product manufacturing plants. China also invests in some finished goods, such as cigarette factories. As commodities become less profitable, Chinese investment shifts to the real-estate, insurance, financial sector, and technology (Hanoitimes.com.vn 2016).

Over the last two years, the Chinese economy has slowed down considerably, which one would expect to adversely impact Chinese ODI. The opposite has happened, however, as Chinese ODI continues to flow. Many economists believe that Chinese investors are searching for higher returns than the slowing Chinese economy can yield. Consequently, in 2016, there has been a dramatic increase in Chinese investment in Vietnam, which is reaching record levels (Hanoitimes.com.vn 2016).

6. Problems with China Investment in Vietnam

In spite of Vietnam's advantageous demographics and solid economic indicators, Chinese investment in Vietnam has not been immune to setbacks. The Hanoi Times reported that, due to past business failures, the Beijing government has advised SOEs to only take minority shares in new ventures, partnering with local companies so that they can benefit from local market knowledge (Hanoitimes.com.vn 2016).

Corruption is one of the ongoing problems which detracts from Chinese investment in Vietnam. Transparency International's 2014 Corruption Perceptions Index ranked Vietnam as the 119th most corrupt country, of only 175, in the world. GAN Integrity's 2015 Vietnam Corruption Report claims that "Companies are likely to experience bribery, political interference and facilitation payments." The report goes on to state that corruption exists in the courts, among the police, public services, land administration, tax administration, and customs. Global Security Org has said that "Corruption and administrative red tape within the Government has been a vast challenge for Governmental consistency and productivity and for foreign company doing business in Vietnam" (Global Security Org n.d).

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Although China and Vietnam are two of the last five remaining communist countries on Earth, their relationship has been anything but amicable. The Sino-Vietnam war in 1979 left scars on the relationship which reopen at the slightest provocation. For example, in 2014, there were violent protests in Vietnam against Chinese companies and citizens as a result of the "HYSY 981 oil rig fiasco, which not only sent protesters out into the streets, but also ended with factories being burned" (Clark 2016).

Vietnamese citizens as well as government officials worry that China could wind up controlling significant sectors of the Vietnamese economy and believe some restrictions should be set, particularly with respect to natural resources. The Hanoi Times also reports concerns about China's unilateral benefits from Vietnam trade: "there needs to be a bilateral investment deal to place reasonable limits on China's involvement in Vietnam" (Hanoitimes.com.vn 2016). Vietnam runs a trade deficit with China, prompting some to say that China benefits more from the relationship than Vietnam.

According to a report by Vietnam.vn, Vietnamese people worry that their country is becoming too dependent on China. The same report went on to say that Bui Xuan Khu, Former Minister of Industry and Trade, feels that Vietnam should nonetheless embrace all forms of foreign investment because of the jobs it creates and taxes it generates. By this logic, Vietnam would absorb Chinese technology in order to create its own independent textile and garment manufacturing industry, which will be competitive on world export markets (English.Vietnam.vn 2014).

'Buy Vietnamese' campaigns have periodically arisen in Vietnam following various political squabbles between the two countries, particularly after sovereignty disputes in the South China Sea. Within the Vietnamese government there is fear that Vietnam will become too economically dependent on China. While Vietnam runs a trade deficit with China it runs a surplus with both the US and the EU, driving Vietnam to embrace the Trans-Pacific Partnership (TPP) (Clark 2016). The TPP, one of the largest trade deals in history, was signed among 12 countries: Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, United States, and Vietnam. Significant is that the PPT includes the US but excludes China. The treaty is expected to boost Vietnam's exports by as much as 28% (Boudreau 2015). With tensions high, particularly regarding sovereignty issues in the South China Sea, and with many Vietnamese fearing becoming economically dependent on China, any problem with a Chinese project in Vietnam becomes a threat to bilateral trade. For example, the Chinese company building the Cat Linh–Ha Dong railway in Hanoi has been running behind schedule. As a result, –many in the Vietnamese government have suggested abandoning the China contract in favor of forming a new agreement with a Japanese company. “"Prime Minister Nguyen Xuan Phuc publicly scolded the company. One transport expert quoted in local Vietnamese news suggested that Vietnam should entrust such projects to more experienced nations like Japan" (Clark 2016).

In spite of the above-mentioned difficulties, in 2016, China pledged to increase its overseas direct aid to Vietnam, (ODA), building schools and hospitals (Clark 2016).

7. Conclusion

China and Vietnam, two of the world's last remaining communist countries, have followed a similar program of economic reforms, moving from a command economy to "socialism with Chinese characteristics" and "market socialism," respectively. Neighbors, they share similarities in terms of their fast-paced growth and movement from extremely poor to middle income in just a few decades. Vietnam's demographic and economic indicators make it an extremely desirable destination for outbound investment. Consequently, trade between the two countries had been robust, with China becoming one of Vietnam's most important economic partners. At the same time, corruption within Vietnam as well as political tensions threaten to dampen the economic relations between them.

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