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The Future Factory of the World: Is Vietnam Ready?

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The Future Factory of the World: Is Vietnam Ready?

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December 2024

Abstract:

This paper provides a comprehensive analysis of Vietnam's foreign direct investment (FDI) inflows in light of ongoing global supply chain restructuring. In particular, it highlights the effects of the US–China trade war and the emergence of friendshoring and nearshoring strategies on Vietnam's positioning as an attractive FDI destination. The study also evaluates the feasibility of Vietnam's ambition to become the next “world's factory,” outlining key opportunities and potential challenges. Taken together, the findings underscore Vietnam's increasing prominence in global supply chains and offer insights into the broader implications of geopolitical shifts on manufacturing and trade patterns.

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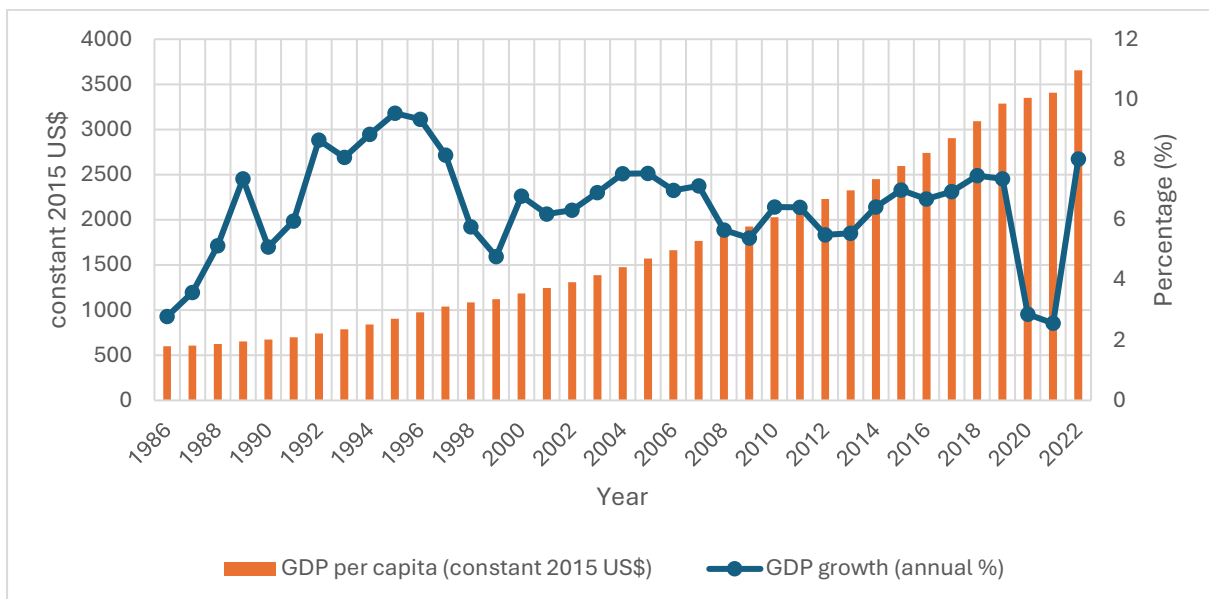
I. Introduction

In recent years, a series of significant and disruptive events have reshaped the global landscape, challenging the established business-as-usual model and the prevailing trend of globalization. Commencing with the United States (US)-China trade war in 2018, the world faced unprecedented challenges, marking a departure from the accustomed norms. This was followed by the Covid-19 pandemic, which wreaked havoc on the global supply chain. The imposition of lockdown measures forced the closure of factories and imposed transportation constraints, further complicating the intricacies of international trade.

Most recently, the world has grappled with the repercussions of the Russia-Ukraine war, which highlights the vulnerability of European energy dependencies. These events have prompted countries, such as the United States, to re-evaluate their stance on globalization and explore new strategies to navigate this evolving landscape, such as "friend-shoring". Unlike reshoring, which brings production processes back home, and nearshoring, which moves production to nearby countries for cost savings, friend-shoring involves relocating production to countries with strong bonds of friendship, trust, and shared values (Kessler, 2022).

Amidst global upheavals, Vietnam has emerged as a country poised to reap substantial benefits. As a developing country with a population of 100 million people (World Bank, 2023b), coupled with a stable political system, Vietnam has increasingly become an attractive destination for foreign direct investment over the past two decades. Boasting an impressive average Gross Domestic Product (GDP) growth rate of over 6% per year, the highest among the Association of Southeast Asian Nations (ASEAN), Vietnam transitioned into a middle-income country in 2011. The nation also demonstrates economic resilience, with GDP growth recovering swiftly after dips (Figure 1). Yet, there remains untapped potential for further elevation, especially considering the current global circumstances.

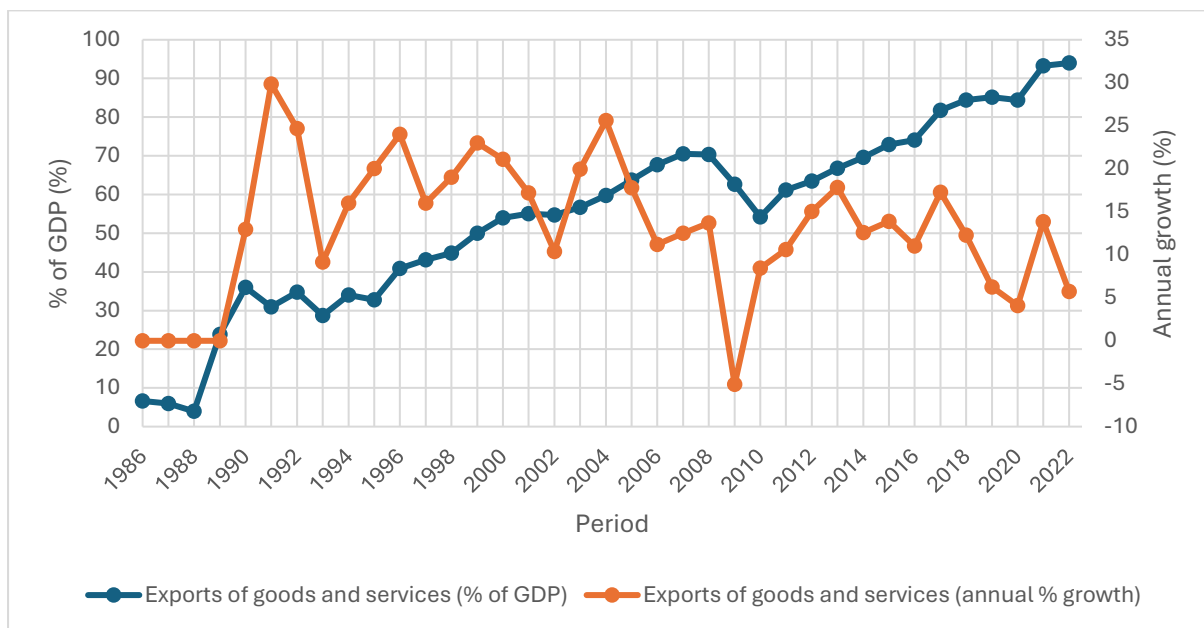
Figure 1: Vietnam's GDP (1986-2022)



Source: Author's design using World Development Indicators (World Bank, 2023b)

One of the most significant contributors to this development is Vietnam's export sector, which has emerged as a key driver of economic growth, particularly since the Doi Moi (Renovation) reform in 1986 (Figure 2). Between 1988 and 1990, the share of exports of goods and services in Vietnam's GDP experienced a remarkable surge, skyrocketing from a modest 4% in 1988 to a substantial 36% by the end of 1990. Despite a brief dip following the 2008 Global Financial Crisis, the growth trajectory has remained strong, even during the pandemic. From 2020 to 2021, the share of exports in GDP increased by over 9 percentage points, one of the most substantial increases since the 1990s. As of 2022, exports constituted over 94% of Vietnam's GDP, marking the country as the second-highest among ASEAN nations in this metric.

Figure 2: Vietnam's exports of goods and services (1986-2022)



Source: Author's design from World Development Indicators (World Bank, 2023b)

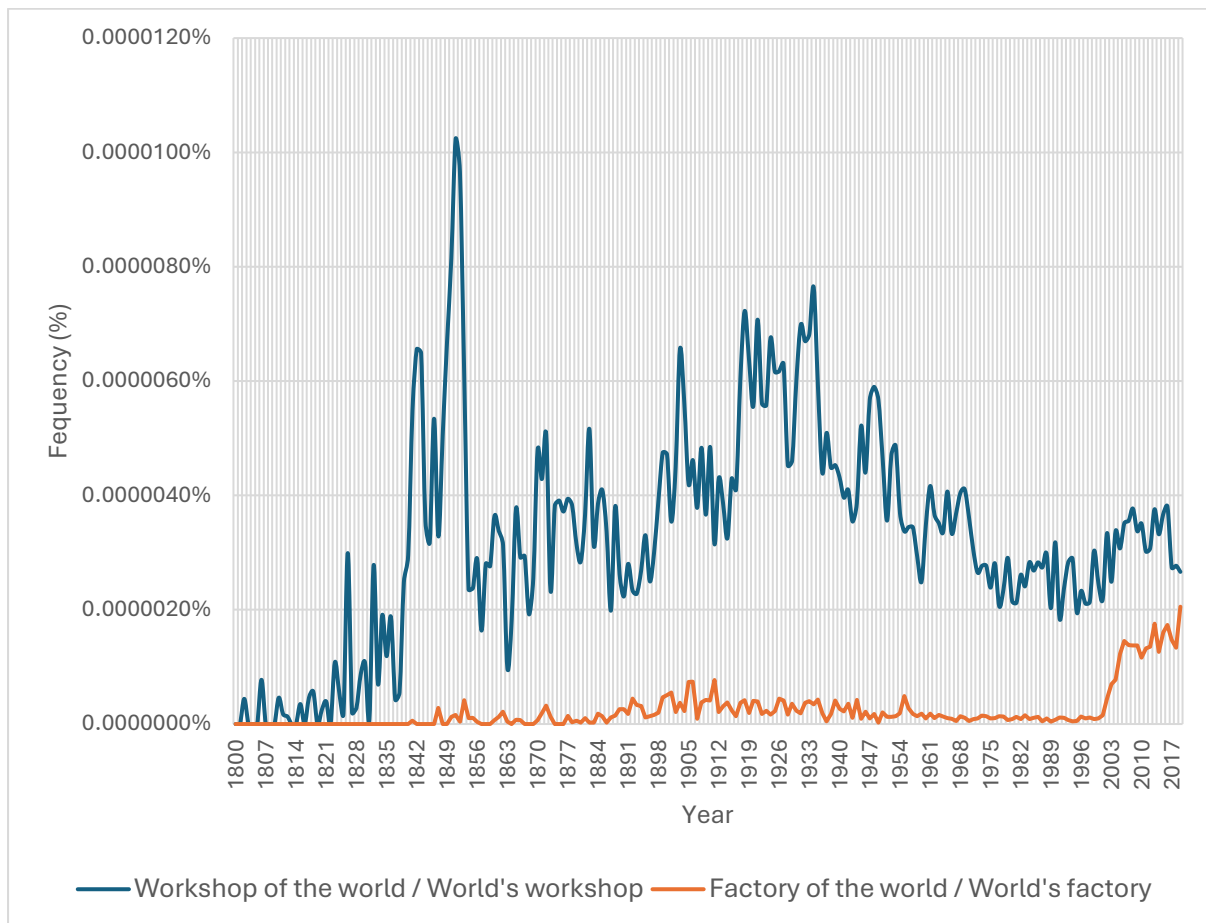
In this paper, we aim to provide a comprehensive analysis of Vietnam's FDI inflows, examining both its historical trajectory and the current context, particularly in light of the ongoing US-China trade war and the rising trends of friendshoring and nearshoring. We also explore how FDI has shaped Vietnam's manufacturing industries over the years, and assess the plausibility of Vietnam's approach to becoming the next "world's factory."

Definition of "World's Factory"

The undeniable significance of exports, coupled with the ongoing trade war, has fueled speculation that Vietnam could become the next "world's factory" after China. However, the precise definition of this term remains debatable, requiring further clarification and exploration of the prerequisites necessitated to achieve such status. We delve into the complexities surrounding the concept by utilizing data from Google Books Ngram Viewer to examine the historical frequency of terms like "Workshop of the world," "World's workshop," "Factory of the world," and "World's factory" from 1800 to 2019 (Figure 3). This linguistic exploration aims to shed light on these terms' historical context and prevalence,

providing valuable insights into the evolving perceptions and narratives associated with countries assuming the role of a global production powerhouse.

Figure 3: Frequency trends of global production terms (1800-2019)



Source: Author’s design from Google Books Ngram Data (Google, 2023)

The term "workshop of the world" emerged much earlier than the other terms and is the most commonly used. One of its early and more popular mentions was in the “Universal history from the creation of the world to the beginning of the eighteenth century” (Tytler, 1835), where the author used the term to describe England’s manufacturing advancements in the nineteenth century. The author attributed this advancement to the "steady and progressive increase of the number of inhabitants". This is illustrated by the fact that the number of laborers in these industries in the nineteenth century exceeded England’s total population at the beginning of the eighteenth century.

However, the term was first used as early as 1779 in the book “Miscellanea Critica: Essays & Comment on Current Topics: Excerpts from Edinburgh Foreign Quarterly & Quarterly Reviews”. Even then, the unknown author noted that the status of England as the “workshop of the world” would not last forever as “the population and the capital of other nations increase... [they], like us, are driven to strike out new lines of industry” (*Miscellanea Critica*, 1779, pp. 202) and would eventually replace England. This foresight materialized in the 20th century, as the US, a former British colony, archived twice the population of the

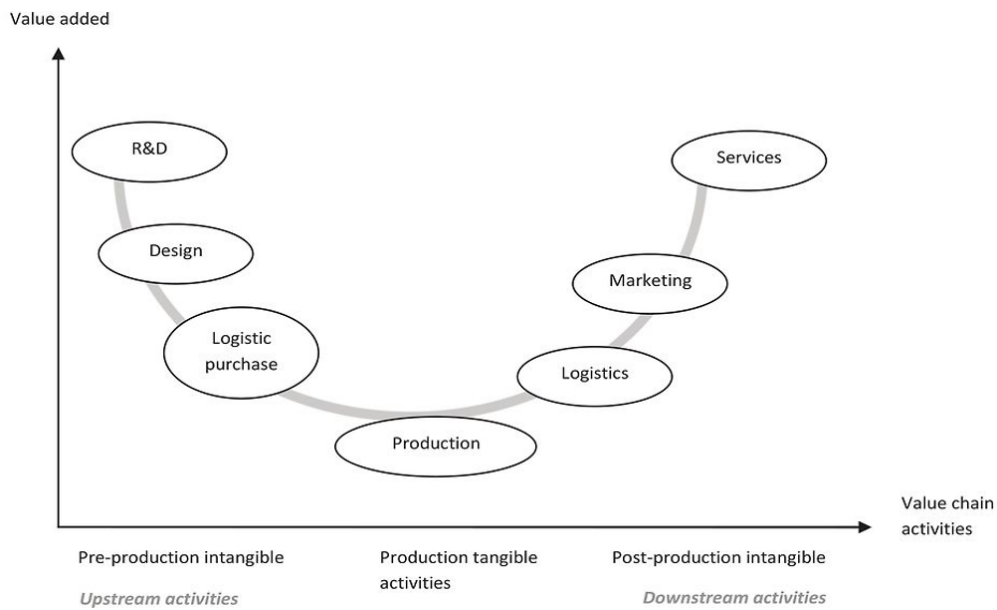
United Kingdom (UK) by 1911 and completely reversed the “relative importance of the two countries” (Barker, 1921, pp. 256). After World War II, largely unaffected by the war compared to Europe and with a growing financial sector, the US quickly replaced England to become the new “world’s workshop”. A common feature in both examples is that population was one of the main determinants for a country to achieve the status of a “world workshop.”

The earliest instance of the usage of “factory of the world” we could find was in “Facts and Figures” (1841), where the author insisted that by maintaining the Corn Law, England would become the “cotton factory of the world”. However, terms involving “factory” were used sparingly compared to “workshop” and only gained popularity at the start of the 21st century. Over the past two decades, the terms “world’s factory” or “factory of the world” have seen a rapid increase in usage. This rise in popularity can be attributed to China's official entry into the World Trade Organization in 2001 and the surge of China's imports into the global market, particularly the US, a phenomenon later known as the “China Shock”. Nowadays, these terms are almost synonymous with China and regularly used to describe China’s role in the world economy.

But despite their similarities and often being used interchangeably, the terms “workshop” and “factory” are not equivalent. Gao (2011, pp. 3) defines a “workshop” as “a room or building that provides both the area and tools (or machinery) that may be required for the manufacture or repair of manufactured goods”. A “factory”, on the other hand, is described “a large industrial building where workers manufacture goods or supervise machines processing one product into another...Archetypally, factories gather and concentrate resources—workers, capital, and plant” (Gao, 2011, pp. 3). This implies that a “factory” exhibits a higher/more valuable characteristic than a “workshop”.

The distinction between the terms “workshop” and “factory” is important when analysing how a country's role as a "factory" or "workshop" contributes to the global value chain. The Smiling Curve, a theory proposed by Stan Shih in 1992, can be used to illustrate this. Shih observed that in the information and communication technology (ICT) sector, the most value is added during the early and late stages of the product life cycle, such as research and development (R&D), design, branding, sales, and after-sales service, while the middle stages, including manufacturing, marketing, and distribution, are associated with lower value and profitability (Figure 4).

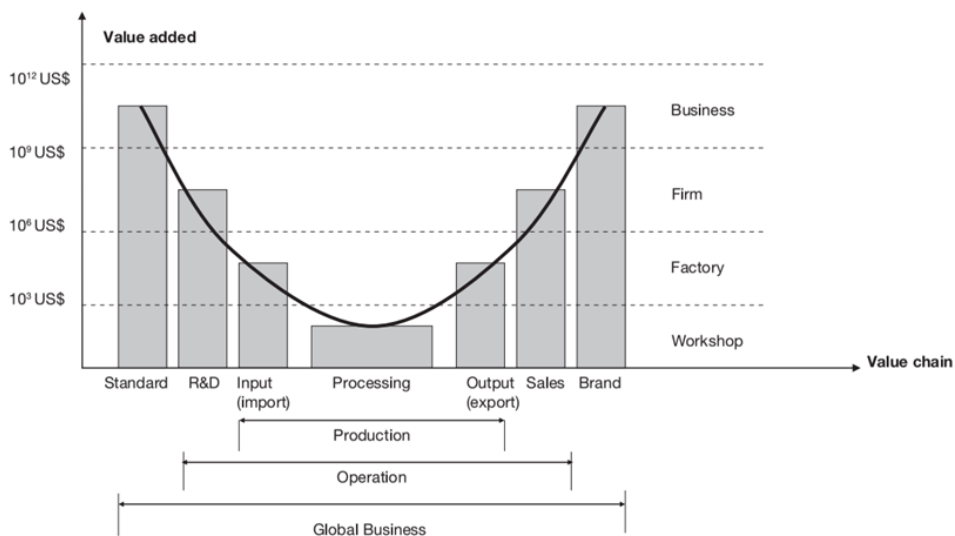
Figure 4: The smiling curve: Value added along the global value chain



Source: Interconnected Economies: Benefiting from Global Value Chains (OECD, 2013)

Gao (2011) improved on this idea by assigning a “status” to each process of the curve (Figure 5). “Workshops” occupy the lowest part of the curve, contributing the least value to the chain by only handling manufacturing and some logistics. This role is usually reserved for developing countries with a cheap and abundant labor force, such as China in the 2000s and Vietnam currently. In contrast, “factories” occupy a higher position on the curve, which not only deals with the “production process” but also the “operation” process including R&D and branding (marketing) of the product. Developed countries, exemplified by the United States, typically assume these higher-level roles, thus capturing more value from the global value chain.

Figure 5: Pattern of the United States as a “world factory”



Source: Gao (2011)

The rest of the paper is structured as follows. Section 2 provides a deeper analysis of Vietnam's manufacturing industries by examining FDI inflows by partner countries, regions, and specific sectors. We also track how these changing FDI patterns have influenced Vietnam's industrial landscape over the past three decades. Section 3 explores the factors driving the growth of FDI inflows into Vietnam, analysing both external influences, such as global economic trends, and internal elements, including labor availability and government initiatives. Section 4 looks into whether the manufacturing shift to Vietnam represents a "relocation" or an "expansion," with a particular focus on the redirection of FDI from China to Vietnam. Section 5 highlights the challenges Vietnam faces in attracting new FDI and pursuing its goal of becoming the next "world's factory". And section 6 concludes.

II. A snapshot of FDI trends and manufacturing industries in Vietnam

This section uses FDI inflows and export data to gain a comprehensive understanding of Vietnam's manufacturing industries. We conduct a detailed analysis of four crucial facets of FDI and exports in Vietnam: geographical distribution within the country, primary FDI partners, FDI composition, and export composition.

FDI trends

Vietnam began attracting significant levels of FDI in the early 1990s, following the implementation of the Doi Moi reforms in 1986. These reforms signalled a transition toward a market-oriented economy and fostered openness to foreign investors. Prior to this shift, FDI inflows were negligible.

Between 1990 and 1995, FDI inflows skyrocketed from nearly zero to over USD 2 billion, with 1995 marking a peak in registered projects. This surge coincided with Vietnam normalizing diplomatic relations with the United States and joining ASEAN. This era, later termed the "First Wave of FDI in Vietnam," lasted until 1997, when the Asian Financial Crisis disrupted investor confidence across the region. As a result, FDI inflows into Vietnam declined significantly and remained subdued until 2000.

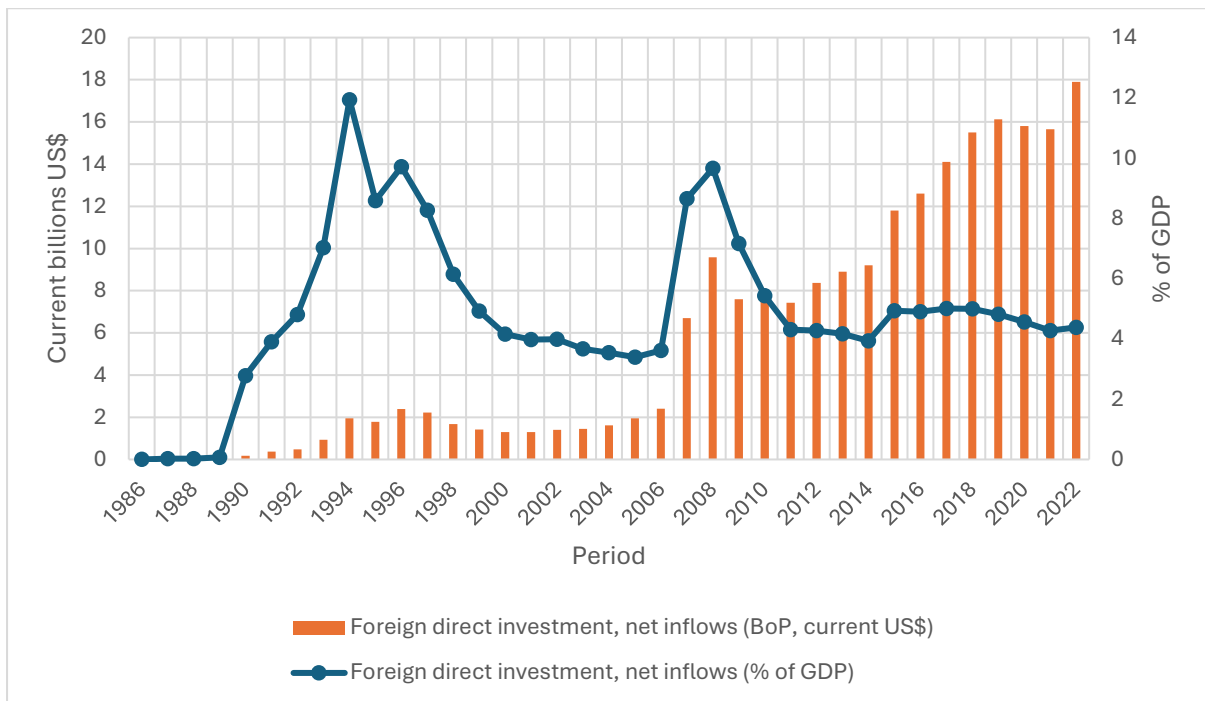
From 2000 onward, FDI inflows into Vietnam stabilized and began to grow gradually, culminating in a significant spike during 2007-2008. This surge coincided with Vietnam's accession to the World Trade Organization (WTO) in 2007, which boosted investor confidence and solidified the country's position in the global trade system. Another key factor contributing to this peak was the introduction of the Investment Law in 2005, which took effect in 2006 (Do, 2008). This legislation was designed to establish a transparent and equitable investment framework, attracting foreign investors by eliminating discrimination between domestic and foreign investors. By 2008, FDI inflows had reached nearly USD 10 billion, marking the peak of what became known as the "Second Wave of FDI". However, this wave was abruptly curtailed by the onset of the Global Financial Crisis later that same year, which disrupted global investment flows.

Since 2010, FDI inflows have continued to grow steadily in value and exceeded USD 10 billion for the first time in 2016, opening up the Third wave of FDI. The growth in this period reflects Vietnam's rise as a major hub for manufacturing, especially in electronics, textiles, and other export-driven industries. Major multinational corporations such as

Samsung, Intel, and LG have contributed significantly to this growth by establishing large production bases in Vietnam.

In terms of FDI as a percentage of GDP, the trend shows that FDI has consistently accounted for around 4-6% of Vietnam’s GDP over the past two decades, except for sudden spikes at the start of the First and Second FDI waves. This indicates that while the absolute value of FDI inflows has increased, the proportion relative to the size of the economy has stabilized, suggesting a mature and balanced integration of FDI into Vietnam’s economic structure.

Figure 7: Vietnam’s foreign direct investment (1986-2022)

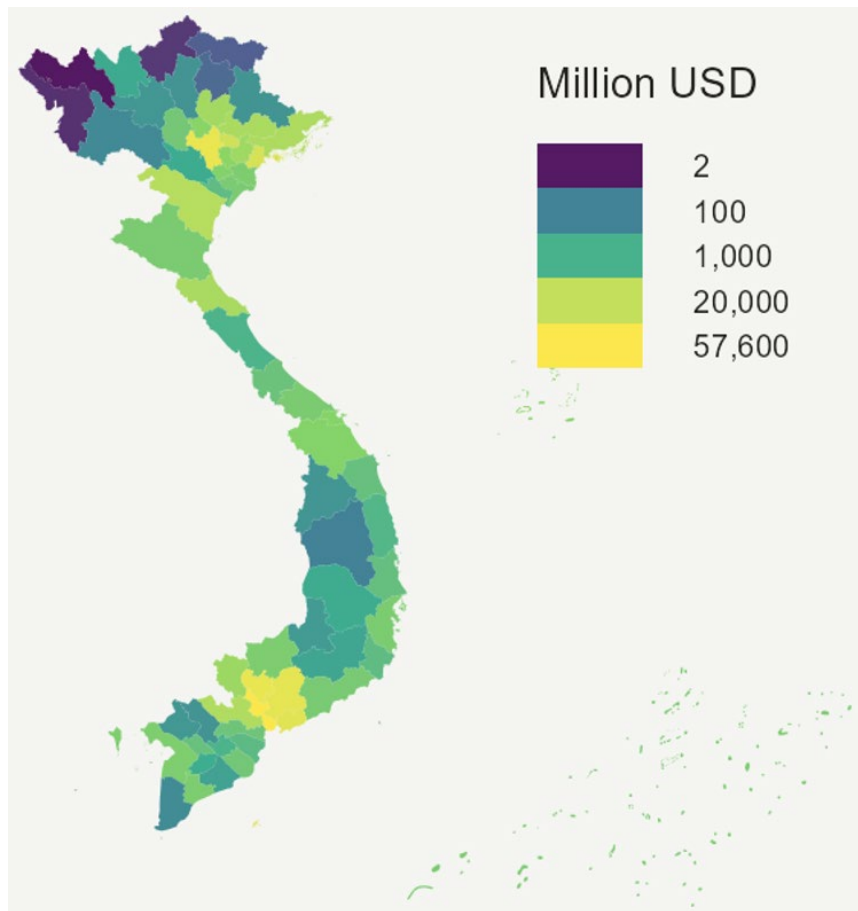


Source: Author’s design from World Development Indicators (World Bank, 2023b)

FDI distribution in Vietnam

Foreign investment in Vietnam is not distributed equally across the country. This difference reveals significant regional disparities, with the Southern and Northern regions emerging as key focal points (Figure 8). Aligned with the government's strategic economic regions, namely the Southern Key Economic Zone (SKEZ) and the Northern Key Economic Zone (NKEZ), these areas exhibit distinct characteristics and investment compositions shaped by geographical factors and governmental strategies.

Figure 8: Accumulated total registered investment capital by province (1998 - 2023)



Source: Author's design using Ministry of Planning and Investment FDI Data (Ministry of Planning and Investment, 2024)

The **Southern Key Economic Zone (SKEZ)** stands out as Vietnam's largest and earliest FDI destination. Encompassing provinces such as Ho Chi Minh City, Binh Duong, Dong Nai, Long An, Ba Ria-Vung Tau, Binh Phuoc, Tay Ninh, and Tien Giang, this region has accumulated nearly USD 200 billion in registered investments from 1988 to 2023, contributing to 42.7% of the country's total FDI. Ho Chi Minh City leads the pack, securing the highest total investment of \$57.6 billion, constituting a 12% share. Known for its substantial labor force and boasting the country's largest commercial port (Ho Chi Minh City Port), the SKEZ offers a diverse range of manufacturing services compared to other economic zones. Notably, it dominates the apparel and footwear industry, with Ho Chi Minh City, along with Dong Nai and Binh Duong, emerging as the primary manufacturing hubs for these products nationwide (Nguyen, 2023).

However, a small-scale relocation has also been taking place within the SKEZ. Although Ho Chi Minh City still holds a dominant position, its share in the nation's industrial structure has gradually declined (Vien Thong, 2023), with the sharpest decrease was in the manufacturing and processing industries such as textiles and footwear at 3.34% per year (Le et al., 2023). Many labor-intensive firms have decided to move their bases out of Ho Chi Minh City to neighboring provinces like Binh Duong, Long An. The reasons for this exodus

can be attributed to lacking workforce due to the trend of workers leaving megacities, exacerbated by the Covid-19 pandemic (Nguyen, 2024; VTV, 2021), the rising land rent and labor costs (Thu & Le, 2023), as well as the direction from officials to move labor-intensive industries out of the city in favor of high-tech industries (Thu, 2022).

The Northern Key Economic Zone (NKEZ), comprising provinces such as Hanoi, Hai Phong, Quang Ninh, Vinh Phuc, Bac Ninh, Hai Duong, and Hung Yen, holds the second-largest FDI capital in Vietnam, with USD 132 billion in investment from 1988 to 2023, constituting 28.42% of the total share. Despite a lower investment volume than the SKEZ, the NKEZ has witnessed a noteworthy surge in recent years, particularly in high-value industries such as electrical equipment manufacturing. Major electrical manufacturing facilities, including Samsung—one of Vietnam's biggest FDI investors—are strategically located in the North.

Several factors contribute to the attractiveness of the Northern region for electrical manufacturing companies. Proximity to China facilitates swift material imports and product shipments, aligning with the China Plus One strategy. Additionally, transportation infrastructure is better in the north, with more highways connecting satellite provinces to the central hub (721km versus 150km in the Southern Region). In fact, in the first 9 months of 2022, the total product transported by land in the Northern region was double that of the Southern region (Hoang, 2022). Lastly, the presence of vital mineral mines in the North, notably rare earth minerals which Vietnam has the second largest reserve in the world, positions the Northern region as a key global destination. The rare earth minerals are particularly significant for manufacturing semiconductors and electrical devices (Nhi Anh, 2023).

Table 1: Samsung suppliers in Vietnam by province, region in 2022

Province	Region	Factories
Bac Giang	North	2
Bac Ninh	North	11
Dong Nai	South	1
Hanoi	North	2
Ho Chi Minh City	South	2
Hoa Binh	North	2
Hung Yen Province	North	1
Ninh Binh	North	1
Phu Tho	North	1
Thai Nguyen	North	2
Vinh Phuc	North	3

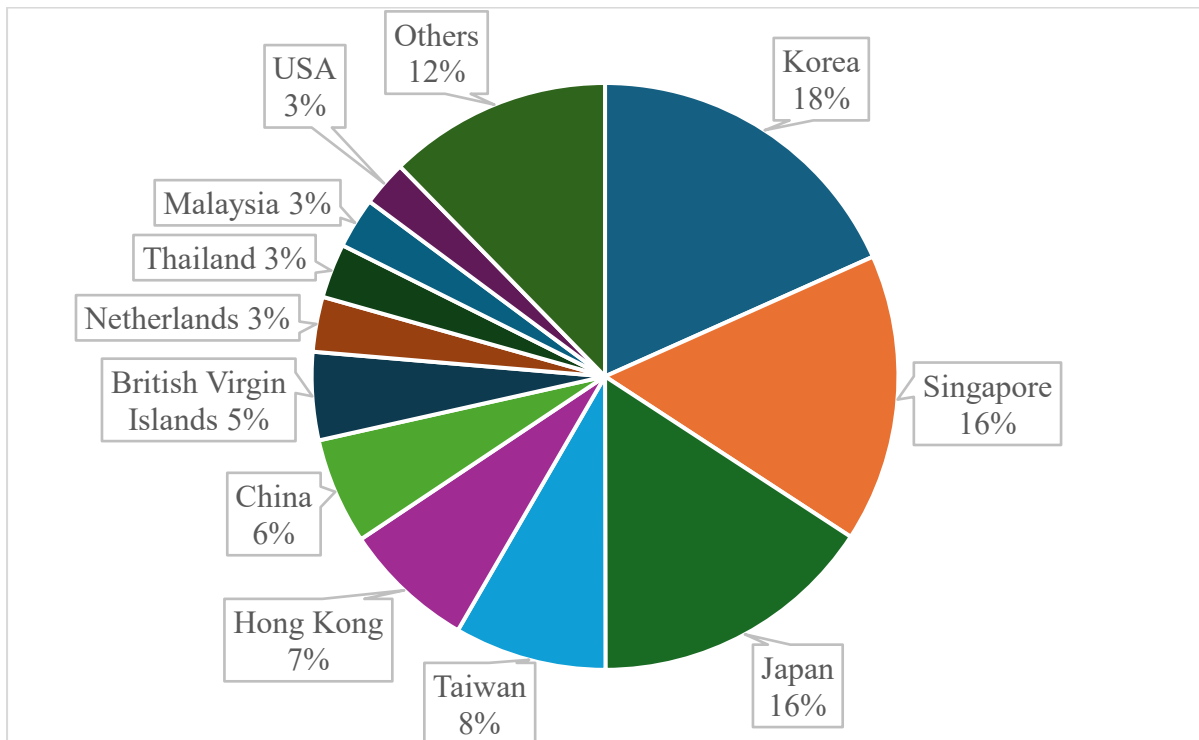
Source: Where are Samsung's Factories in Vietnam? (Barnes, 2023)

FDI partners

East Asia stands as the predominant contributor to FDI in Vietnam, with investments from five East Asian countries—Korea, Japan, Taiwan, Hong Kong, and China—constituting more than 55% of the total (Figure 9). Notably, Korea takes the lead, accumulating over

\$85.8 billion in investment, driven significantly by major Korean investors such as Samsung and LG.

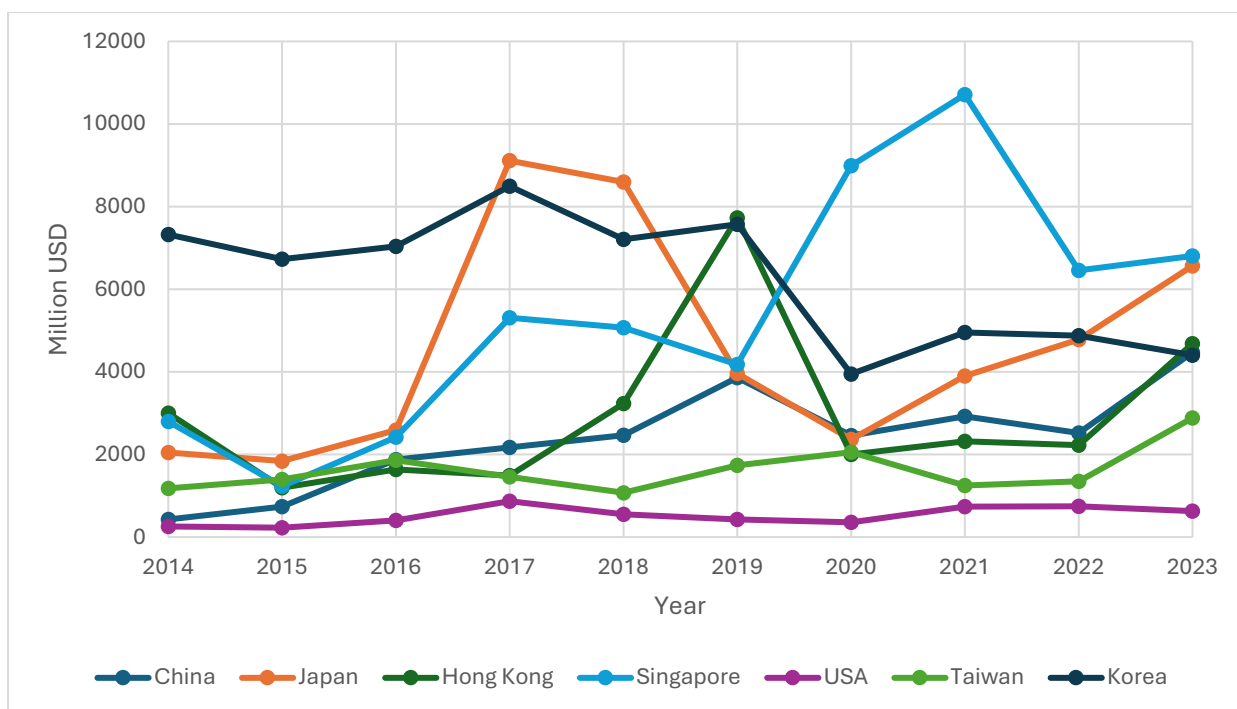
Figure 9: Accumulated total registered investment capital by partners (1998 - 2023)



Source: Author's design using Ministry of Planning and Investment FDI Data (Ministry of Planning and Investment, 2024)

However, the investment landscape has shifted due to the impact of the COVID-19 pandemic. Korean investments have experienced a recent slowdown, marked by a 9% decrease in 2023 compared to the previous year. Moreover, the average growth of FDI from Korea is -2.4% since 2014. Stepping into the forefront of FDI in Vietnam to fill the space left by Korea is Singapore, which has maintained its position as the top investor for the fourth consecutive year (2020 – 2023) (Figure 10). If this trend persists, Singapore is poised to surpass Korea as the largest investor in Vietnam in the near future.

Figure 10: Annual total newly registered capital, additional capital, and contributed capital by top FDI investors (2014 – 2023)



Source: Author’s design using Ministry of Planning and Investment FDI Data (Ministry of Planning and Investment, 2024)

Despite recent discussions suggesting that Vietnam could replace China as a primary destination for US FDI, the US’s actual investment in Vietnam remains relatively low. Although US investment doubled in 2017 compared to the previous year, during the first year of Trump’s term, it is still notably lower relative to the economic ties between the two countries. Surprisingly, the U.S. doesn’t even rank among the top 10 investors in Vietnam, trailing behind countries like Thailand and Malaysia. While President Biden’s visit to Vietnam has sparked hopes for a new wave of US capital (Yuji, 2023), recent news, such as Intel canceling its expansion plan in Vietnam, cast uncertainties. In fact, from 1988 to 2023, the accumulated total registered investment capital of the US into Vietnam is only USD 11.8 billion, eight times less than Korea. Nguyen (2019) argued that one reason for the lower volume of US FDI in Vietnam is that US investments are more focused on R&D compared to other foreign investors. However, their argument relied on gross domestic spending on research and development, which does not necessarily reflect FDI flows. The other reasons they mentioned, such as the level of technology absorption and transparency in the investment environment, still hold merit and will be discussed later in the section on challenges.

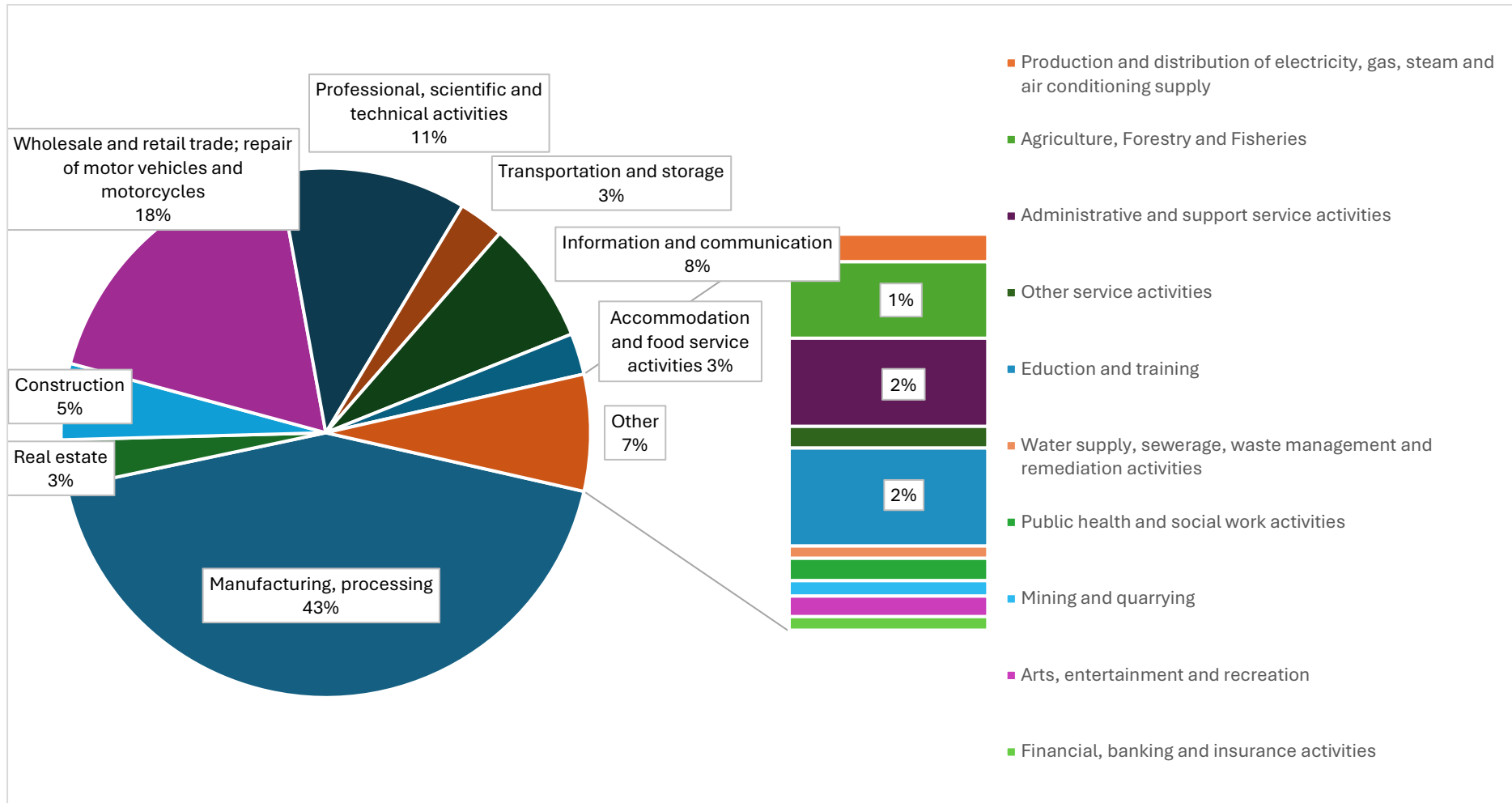
Despite Vietnam’s significant surge in FDI inflows—particularly amid US-China trade tensions—emerging research indicates this might simply reflect an expansion of China’s supply chain into Vietnam. Trivedi (2023) attributes growing manufacturing FDI primarily to Vietnam’s lower labor costs, but also notes that Vietnamese manufacturers in sectors like electrical equipment and machinery still depend heavily on Chinese components. Meanwhile, Jiang (2023) observes that foreign investors are shifting from an “All in China”

strategy to a “China plus N” approach to reduce risk, yet argues that China’s competitive edge remains largely intact. Collectively, these insights underscore the nuanced nature of FDI patterns in Vietnam.

FDI composition

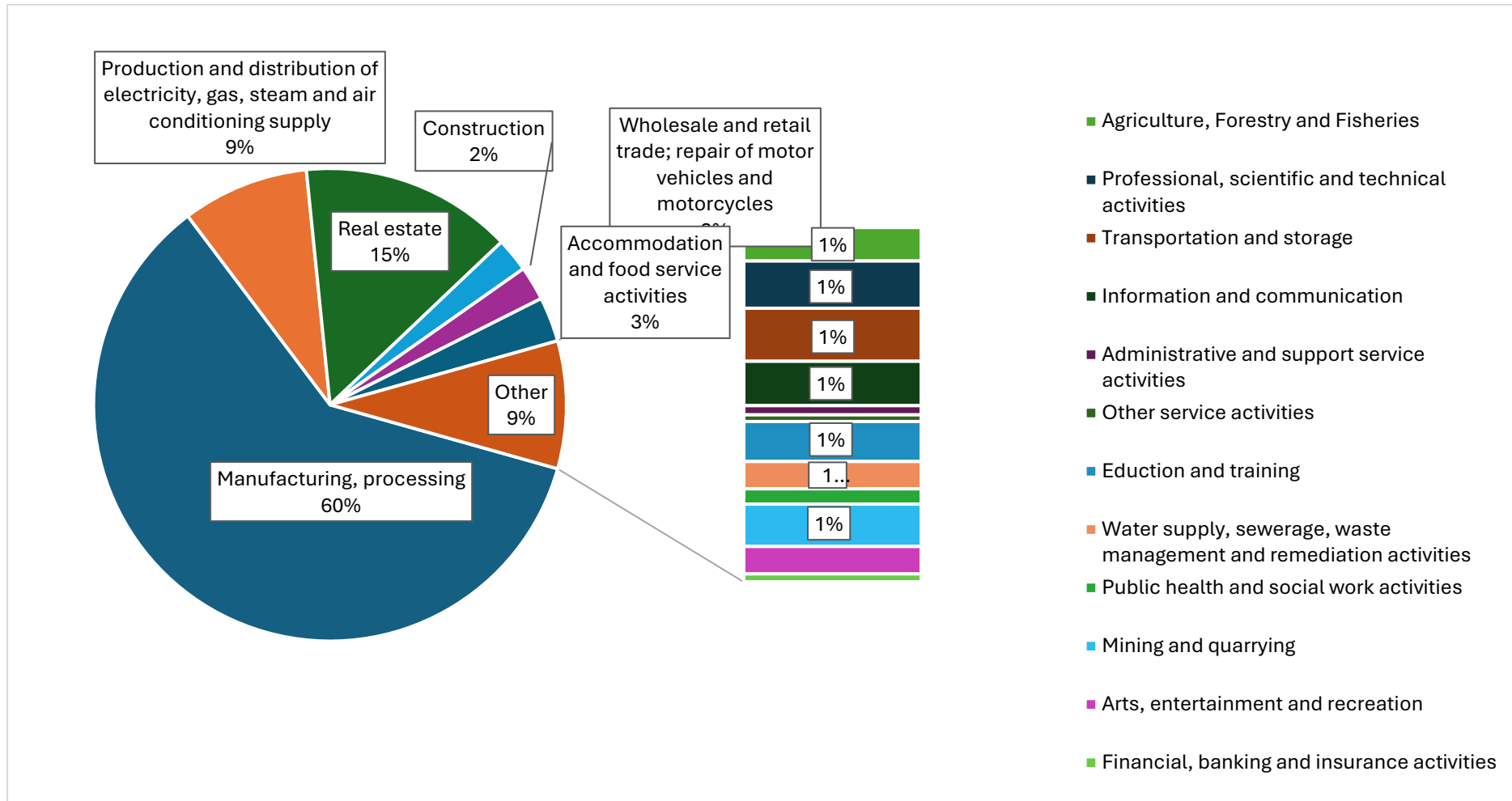
The manufacturing and processing industry commands the largest share in both the total number of projects and their corresponding values. As of 2023, the manufacturing industry boasts 16,875 new projects since 1988, accounting for a substantial 43% of the total number (Figure 11). When evaluating the value of these investments, the manufacturing sector's dominance is even more pronounced, standing at an impressive USD 283 billion, constituting 60% of the total investment value (Figure 12). This dominance is attributed to the substantial capital infusion in manufacturing projects, unlike some other sectors where project numbers may be high but the capital investment remains comparatively low. For instance, the wholesale and retail trade sector, although representing 18% of the projects, contributes merely 2% to the total value. Similarly, professional, scientific, and technical industries, constituting 11% of the projects, contribute a mere 1% to the overall investment value.

Figure 11: Accumulated number of newly granted FDI projects by industries (1998 - 2023)



Source: Author's design using Ministry of Planning and Investment FDI Data (Ministry of Planning and Investment, 2024)

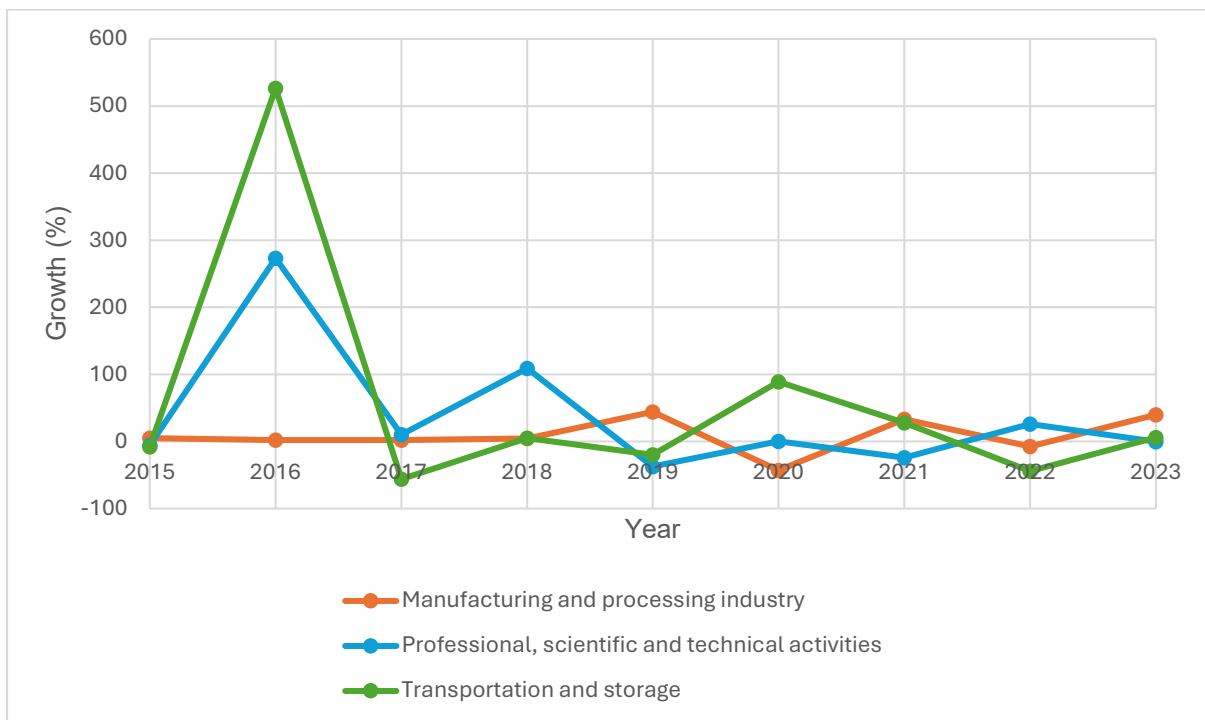
Figure 12: Accumulated total registered investment capital by industries (1998 - 2023)



Source: Author's design using Ministry of Planning and Investment FDI Data (Ministry of Planning and Investment, 2024)

Regarding manufacturing-related industries, the transportation and storage sector emerges as the top performer, with an impressive average growth rate of 58% (Figure 13). Notably, it peaked in 2016 with a remarkable 526% increase compared to the previous year. The scientific and technical industry exhibits a slower but noticeable growth, boasting an average rate of 38%. However, it's crucial to acknowledge that the total value of these industries remains significantly smaller when compared to the manufacturing industry, each contributing only 1%. This underscores a pivotal challenge for Vietnam, as these industries are instrumental in elevating its manufacturing processes to higher-value steps in the supply chain ladder.

Figure 13: FDI growth by industry (2015 – 2023)

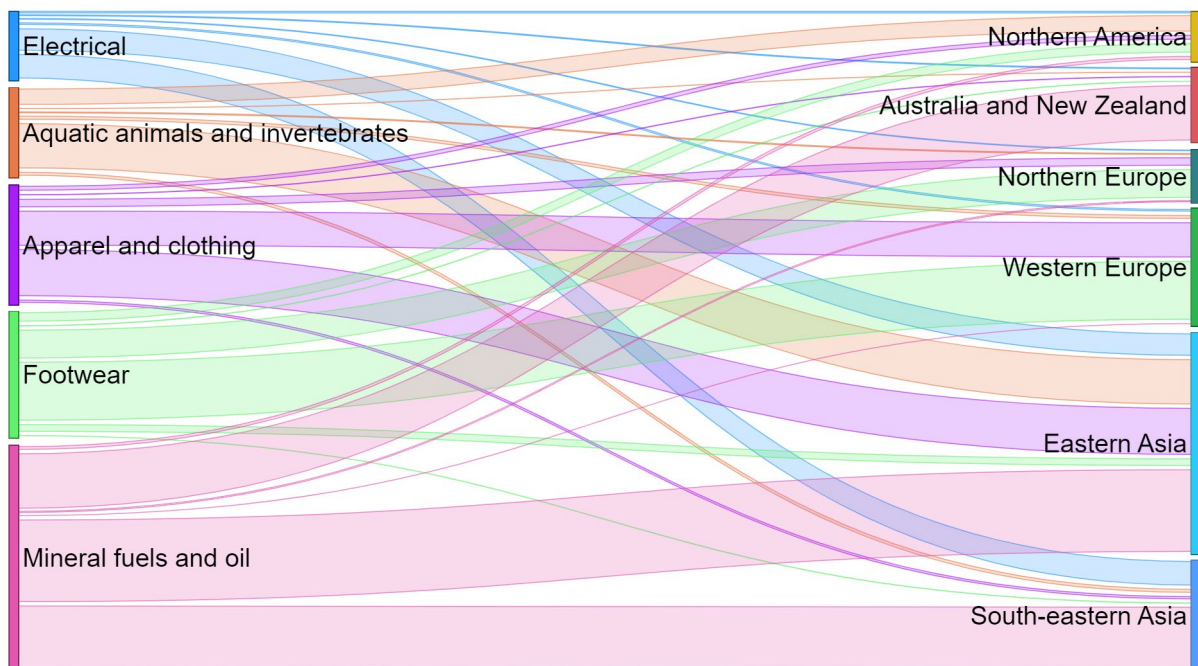


Source: Author's design using Ministry of Planning and Investment FDI Data (Ministry of Planning and Investment, 2024)

Export trends

At the beginning of the 21st century, Vietnam was heavily reliant on its natural resources (Figure 14). In 2000, the largest category of exports was mineral and fuel, accounting for 26.41% of total exports and valued at USD 3.825 billion. Petroleum oils were the leading product in this category, making up more than 91.5% of its total value. Agriculture, forestry, and fisheries products also significantly contributed to Vietnam's exports, with a combined value exceeding 24% during this period, although only Fish and Crustaceans (HS 03) appeared in the top 5 export categories.

Figure 14: Vietnam's exports in 2000

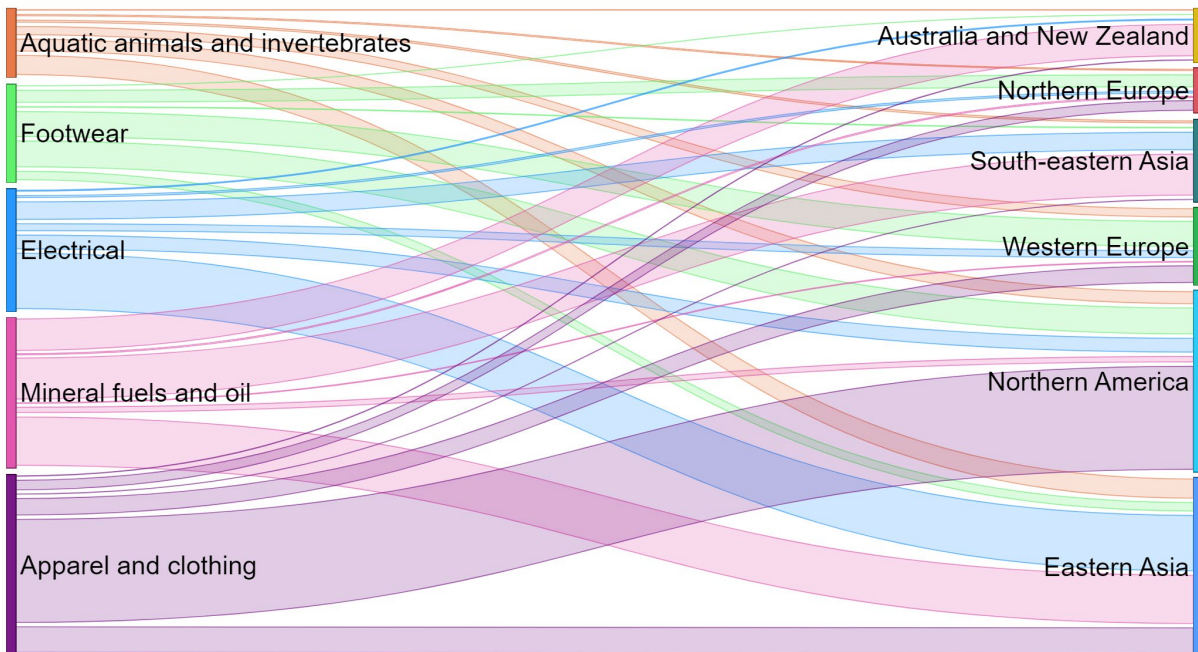


Source: Author's design using CEPII BACI data (CEPII, 2024)

During the 2000s, Vietnam's manufacturing industry started to show signs of growth, driven by the first wave of FDI around 1996. The main manufacturing products during this period were garments and footwear, which accounted for 53% of total FDI capital at that time (Doanh, 2002). These investments were mainly located in the Southern Region, particularly in Ho Chi Minh City, where large footwear companies like Pouchen and Feng Tay (Taiwan) established their factories. Despite this growth, Vietnam's exports were still heavily reliant on its comparative advantages of natural resources and cheap labor (Doan C, 2007).

Vietnam's exports during this period were mainly directed towards Eastern Asia, with Japan being the largest market, accounting for USD 2.58 billion in import value and 17.8% of Vietnam's export share. China was the second-largest market, with a trade value of USD 1.5 billion and a 10.6% share. The main export products to this region were natural resources and processed products with low labor value. The newly established footwear and apparel manufacturing industries primarily exported to European markets.

Figure 15: Vietnam's exports in 2010

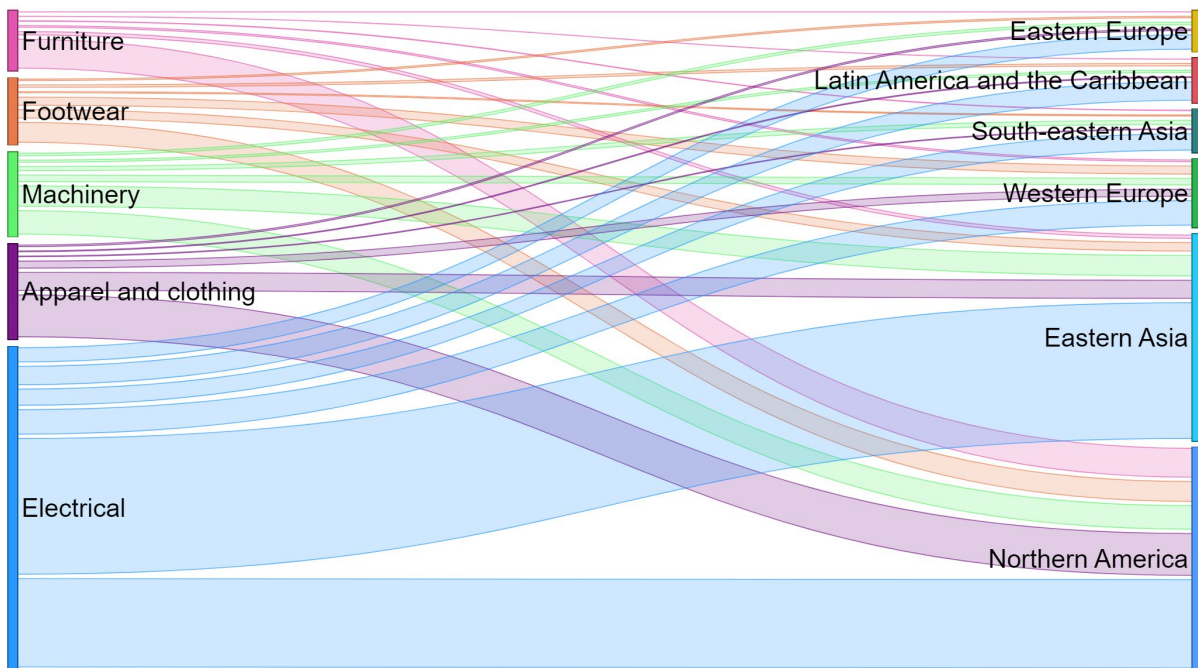


Source: Author's design using CPEII BACI data (CEPII, 2024)

In 2010, there was a significant shift in the export composition of Vietnam's manufacturing industries (Figure 15). While minerals and fuels remained important, their share of total exports fell to second place, accounting for only 10.52%. Apparel and clothing accessories took the first place, with a trade value of nearly USD 11 billion, representing a 428% increase compared to the previous decade. The fastest-growing industry was electrical products, with a value of USD 8 billion, a 7.22-fold increase compared to 2000.

Regarding the product destination, Eastern Asia remained the top market for Vietnam's goods, but Northern America quickly rose to second place, with a trade value of USD 15.7 billion and a 20.5% share of the total exports. The top six sub-regions accounted for more than 80.4% of the total exports.

Figure 16: Vietnam's exports in 2021



Source: Author's design using CEPII BACI data (CEPII, 2024)

Fast-forwarding to 2021, Vietnam witnessed a notable transformation in its export composition, marked by the unequivocal dominance of manufacturing products that entirely eclipsed the top five export categories. Notably, electrical equipment emerged as the top export category (Figure 16).

Despite Eastern Asia maintaining its dominance as the leading trade market with a substantial trade value of USD 114.33 billion, the Northern American market followed closely with a marginal difference of only USD 9 billion between the two regions. Northern America also emerged as the primary market for four out of the top five export categories, excluding electrical equipment. When considering the cumulative trade value from only the top five categories in 2021, Northern American countries surpassed their Eastern Asian counterparts in trade value, reaching USD 81.95 billion compared to USD 75.37 billion. This shift underscored the growing significance of Northern America in the consumption of key product categories, despite their FDI into Vietnam significantly lagging behind that of East Asian countries.

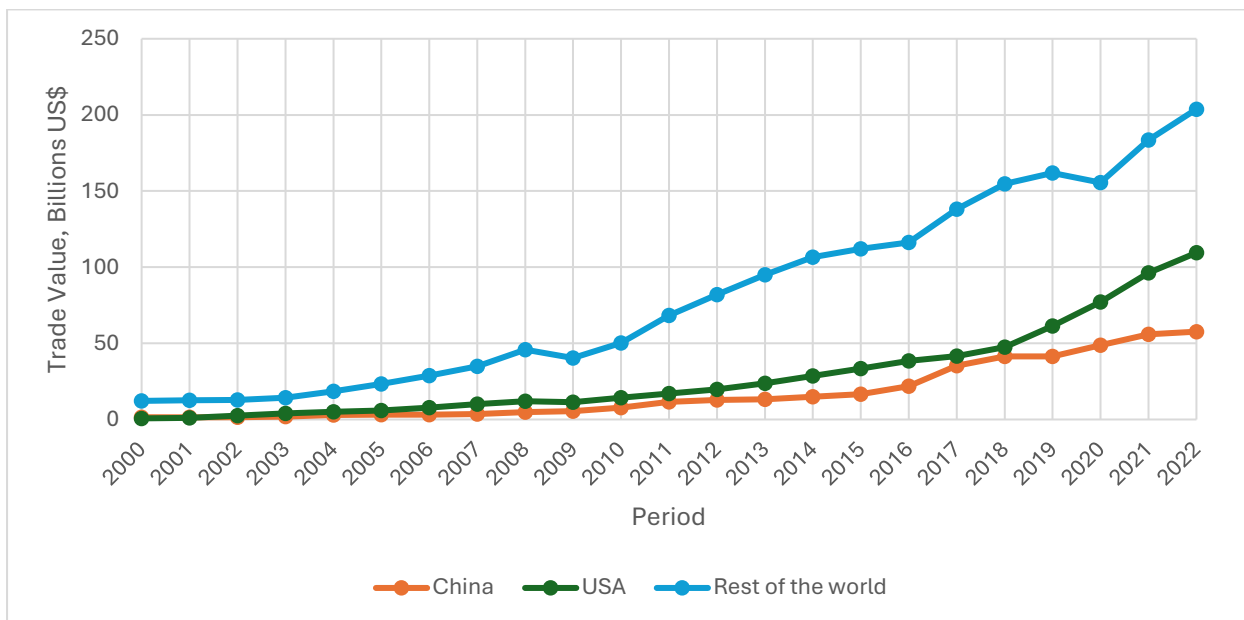
Among Vietnam's major importers, the US has solidified its role as a crucial market driving export expansion. In fact, Vietnam has long regarded the United States as a strategic partner, starting with the signing of the US-Vietnam Bilateral Trade Agreement in 2000, which allowed Vietnam to gain access to the world's largest economy.

Since 2002, the United States has consistently held the position of Vietnam's largest export market, maintaining this status for an impressive 15 years. While there was a brief interlude in 2017 when China reportedly overtook the US (Nguyen, 2018, pp. 2), the US swiftly reclaimed the top spot the following year. Notably, Vietnam has strategically utilized the trade war dynamics to strengthen its economic ties with the United States, resulting in a

remarkable surge in exports to the US from 2018 to 2022 while exports to China experienced relative stagnation. By the end of 2022, Vietnam achieved a historic milestone, with exports to the US reaching an impressive USD 101.2 billion, nearly doubling the USD 57.6 billion of exports to China (Figure 17). Excluding two declines due to the 2008 financial crisis and the Covid-19 pandemic, Vietnam’s exports to the rest of the world have shown a consistent upward trend, reaching USD 203.8 billion in 2022, reflecting a steady rise in Vietnam’s global trade engagement.

In a significant development in September 2023, the US and Vietnam announced the elevation of their relationship to a Comprehensive Strategic Partnership – the highest level of partnership that Vietnam holds with any country (U. S. Mission Vietnam, 2023). This strategic move solidifies the foundation for mutual collaboration and opens avenues for even greater economic and geopolitical advantages for Vietnam.

Figure 17: Vietnam's goods export values by main destinations (2000 - 2022)



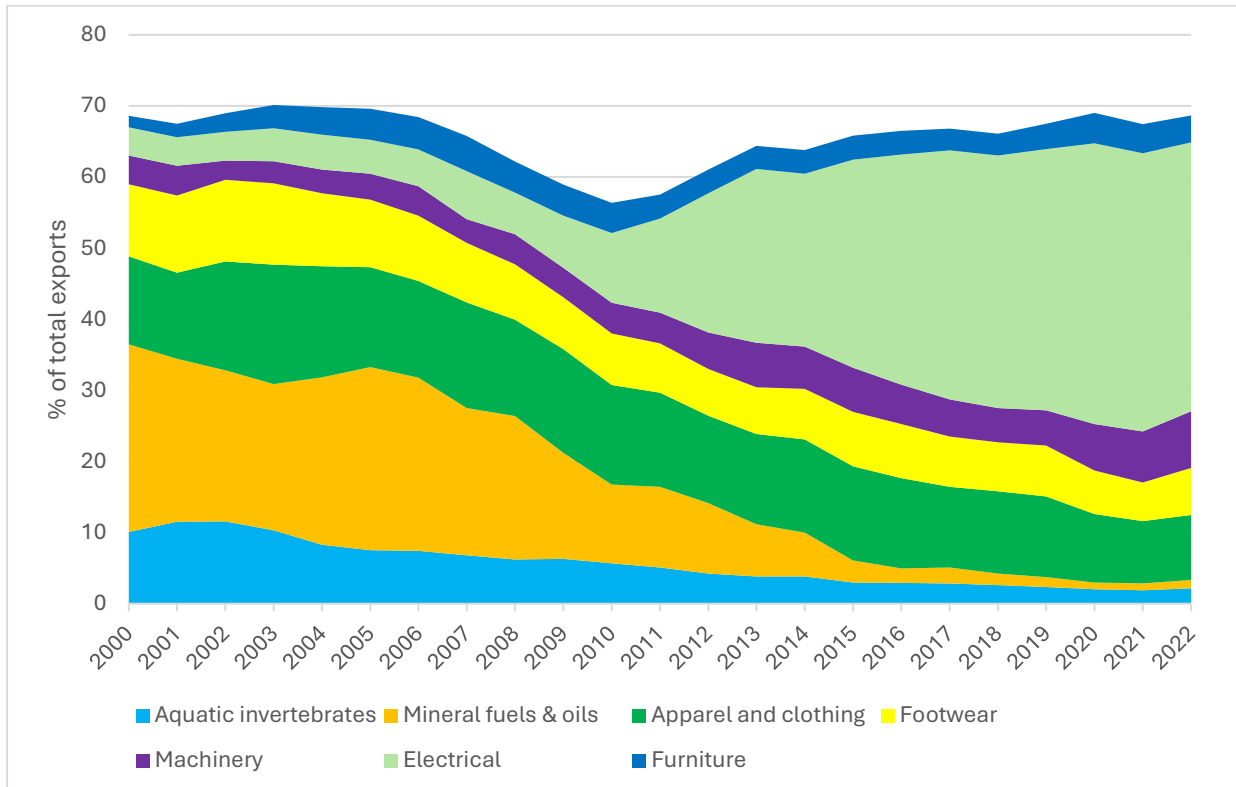
Source: Author’s design from World Development Indicators (World Bank, 2023b)

Vietnam’s export composition also shows the shift from natural resource-reliant industries to manufacturing industries over more than two decades. Despite a marked downturn from 2007 to 2010, potentially due to the global financial crisis, Vietnam’s top 7 exporting products rebounded sharply and consistently accounted for about 70% of Vietnam’s total exports. The electrical machinery and equipment sector stands as Vietnam’s top exporting sector after 2010, reaching a value of USD 140.63 billion in 2022, which is 37.83% of the total exports. This category experienced its highest growth rate in 2010, with an annual average growth rate of more than 33%.

The rapid growth of the electrical machinery and equipment exports was likely spurred by major investments from leading electrical equipment manufacturers. For instance, Intel opened its biggest chip testing and assembly facility in the world in Ho Chi Minh City with a total investment of 1 billion US dollars in 2010 (Dean Takahashi, 2010). However, the biggest investor in the electrical equipment-related industry in Vietnam during this time was

Samsung. In 2008, it started construction for its first mobile phone factory in Vietnam with an initial investment of USD 670 million, which quickly rose to USD 2.5 billion (Hoai, 2023). Later, Samsung Electronics Vietnam Thai Nguyen (SEVT) was constructed, with a total investment of USD 5 billion. Most recently in 2022, Samsung opened its largest regional R&D research facility in Vietnam (Luu, 2022). These investments have boosted Vietnam's manufacturing capabilities, skyrocketing the value of electrical equipment exports to the position it holds today.

Figure 18: Composition of the top 7 product categories in Vietnam's total export (2000 – 2022)



Source: Author's design using Ministry of Planning and Investment FDI Data (Ministry of Planning and Investment, 2024)

Over 22 years, Vietnam has significantly reduced its dependence on heavily natural resource-reliant industries. The minerals and fuels sector, which peaked in 2008 at USD 12.6 billion, has since declined at an average rate of 4% per year. By 2022, it contributes just 1.16% of Vietnam's total exports. This rapid decline could be attributed to the Vietnam Mineral Law passed in 2010 and the change in government strategy to stop relying on natural resources. The same happened to fish and crustacean imports and other agricultural products.

On the other hand, Vietnam's economy continues to be buoyed by labor-intensive low-value-added manufacturing sectors. While footwear and apparel have seen modest reductions, dropping to 6.62% and 9.17% of the total exports in 2022 from 10.16% and 12.36%, respectively, in 2000, the emergence of industries like furniture, which increased from 1.62% to 3.74%, compensates for these changes.

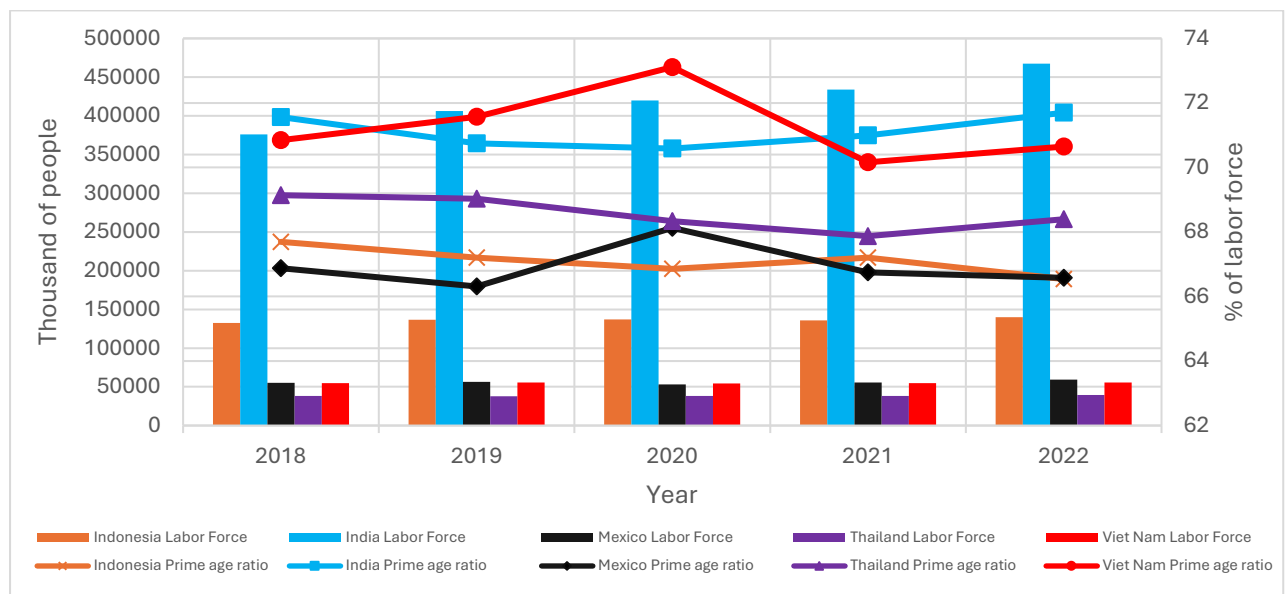
III. Vietnam’s competitive edge: Factors luring foreign investors

In the previous section, we highlighted the growing trend of FDI flowing into Vietnam, particularly within the manufacturing sector. This chapter explores the various attributes that position Vietnam as an appealing manufacturing hub for foreign investors. These attributes can be broadly classified into three main categories: labor force advantages, a favorable environment, and policy incentives. Our analysis reveals that while Vietnam may not be the leader in every dimension, its consistent and relatively high performance across numerous factors has cemented its status as one of the foremost manufacturing destinations in the region for international investors.

Labor force

Boasting a population of 98 million in 2022 (World Bank, 2023b), and ranking 16th globally, Vietnam presents a significant workforce, especially attractive for manufacturing. While not as large as China or India, Vietnam holds the second-largest labor force pool in Southeast Asia, reaching 55.5 million people in 2022, behind only Indonesia. A unique advantage of Vietnam’s workforce is its geographic concentration. The majority is situated in the Red River Delta and the Mekong Delta regions. This clustering compared to the scattered populations of island nations like Indonesia simplifies logistics for recruitment and factory setup.

Figure 39: Labor force and prime age ratio in the labor force (2018 – 2022)



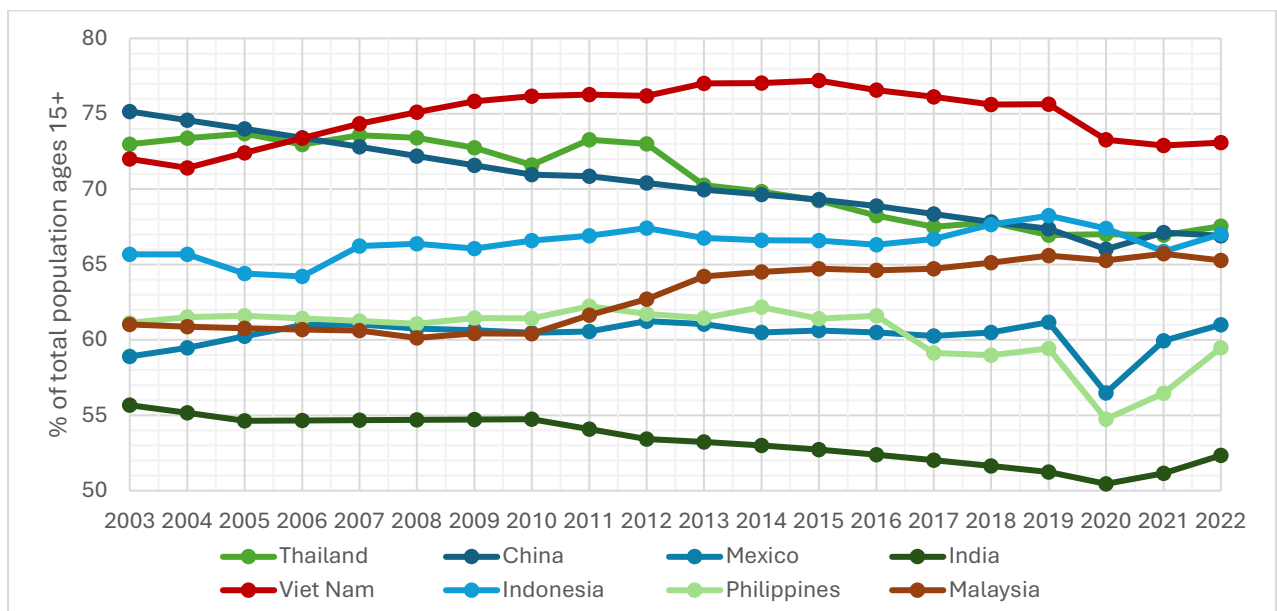
Source: Author’s design using World Development Indicators data (World Bank, 2023b)

Vietnam’s workforce also stands out in Southeast Asia largely due to its favorable age composition. Studies by Nguyen (2021) and Mitra and Abedin (2022) has shown that a young labor force, factors that are particularly vital in the manufacturing and other labor-intensive industries, is closely linked to greater FDI inflows. This advantage is evident in Vietnam’s high share of workers within the prime working age of 25 to 54 – the demographic typically considered as the most productive and healthy for the workforce. In 2022, more than 70% of

Vietnam’s labor force was in the prime working-age bracket, surpassing the proportions in other ASEAN countries, including Indonesia and Thailand (Figure 19). This demographic advantage makes Vietnam highly appealing to investors seeking a young and active workforce.

Additionally, Vietnam boasts the highest labor force participation rate among ASEAN countries (Figure 20). A high labor force participation rate indicates a large pool of available workers and a promising future labor supply. Wahyudi & Palupi (2023) further highlights a reciprocal relationship between labor participation rates and FDI inflows. As of 2022, more than 73% of Vietnam’s working-age population was employed or actively seeking employment, surpassing the figures for Thailand, Indonesia, China, and Malaysia each hovering around 65%-67%. This highlights Vietnam's competitive advantage in terms of readily available labor.

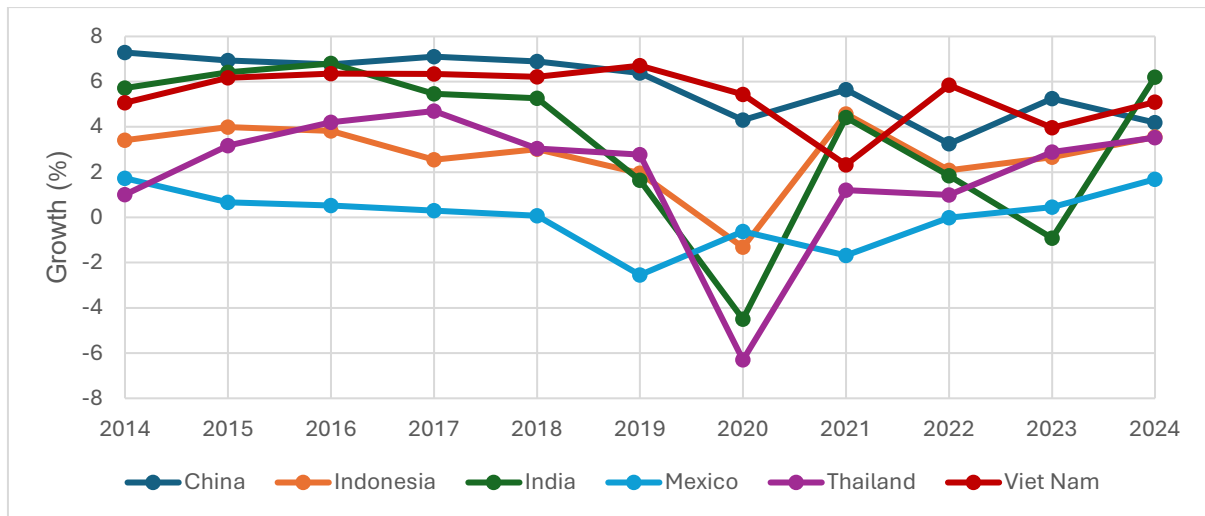
Figure 20: Labor force participation rate (2003 – 2022)



Source: Author’s design using the International Labor Organization data

Vietnam also distinguishes itself with a notably high annual growth rate in output per worker among its main competitors for FDI. Over the decade from 2014 to 2024, Vietnam achieved an impressive annual growth rate of 5.4%, second only to China at 5.8%, and outpacing India (3.4%), Indonesia (2.7%), Mexico (0.05%), and Thailand (1.9%) (Figure 21). Unlike other analyzed countries, Vietnam and China emerged as the least affected countries by the Covid-19 pandemic in terms of output growth, maintaining positive growth throughout this period. This resilience and growth trajectory present Vietnam as an attractive destination for foreign investors focused on long-term potential.

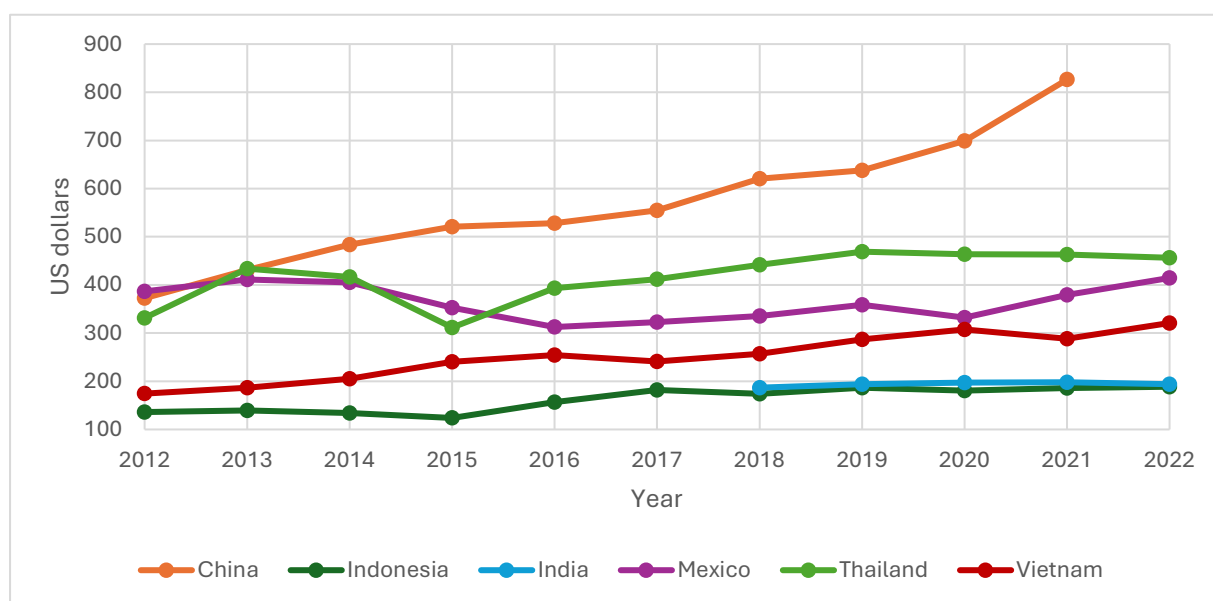
Figure 21: Annual growth rate of output per worker (GDP constant 2017 international \$ at PPP) (2012 – 2022)



Source: Author's design using the International Labor Organization data

Finally, low labor cost is one of the most important aspects of Vietnam's labor market attractiveness. Using the average monthly earnings of workers as a proxy for labor cost (Lankes and Venables, 1996), our analysis reveals that China, previously known for its cheap labor, has seen a rapid increase in average monthly earnings from 2012 onwards (Figure 22). Specifically, Chinese worker earnings jumped from USD 372 in 2012 to USD 826 in 2021, marking a 2.2-fold increase. This surge in labor costs has driven companies to explore more cost-effective alternatives, leading to increased investment in other markets, including Vietnam. In comparison, Vietnamese workers earned an average of USD 321 per month in 2022, significantly lower than China's at roughly 2.5 times less. However, Vietnam faces competition from other Southeast Asian nations. Indonesia and India presented themselves as Vietnam's main rivals in 2022, with average monthly wages hovering around USD 200 – two-thirds of what Vietnamese workers typically earn.

Figure 22: Average monthly earnings of employees (2012 – 2022)



Source: Author’s design using the International Labor Organization data (International Labour Organization, 2024)

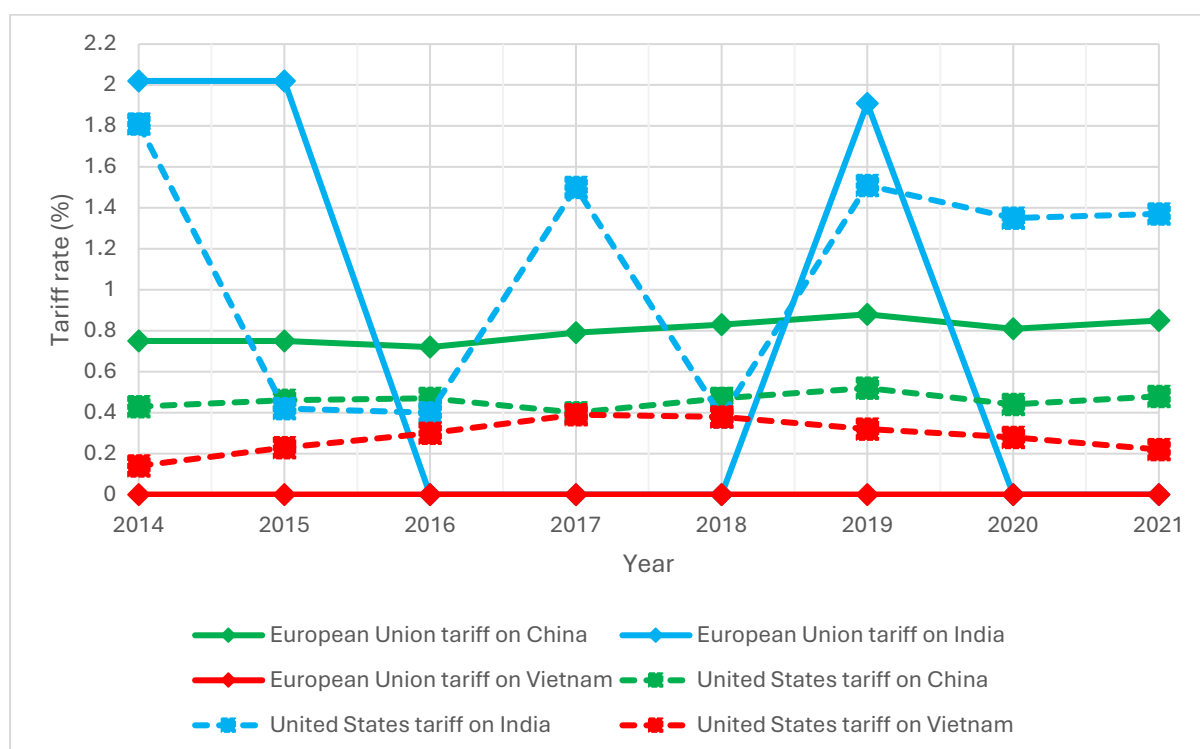
A favorable environment

The trade conflicts between the United States and China have significantly contributed to the favorable environment that has driven Vietnam's recent success in attracting FDI. While the US-China trade conflict’s ultimate winners and losers remain debated, Vietnam has emerged as a clear beneficiary. Research by Rotunno et al. (2024) highlights that Vietnamese exports to the US surged by approximately 40% in 2020 compared to 2017, particularly in sectors impacted by US tariffs on Chinese products. Vietnam also benefits from lower import tariffs imposed by the United States and the European Union than those applied to China and India. This favorable tariff environment grants Vietnam a competitive advantage in important export sectors such as machinery, electrical equipment, and furniture.³

For machinery, US tariffs on Vietnamese products were initially on an upward trend but saw a reversal following the onset of the trade war, decreasing from a peak of 0.39% in 2017 to 0.22% in 2021. In the European market, the tariff rate for Vietnamese machinery remained consistently at 0% throughout the period. Conversely, tariffs on Chinese products witnessed an upward trajectory, with US tariffs reaching 0.48% and EU tariffs at 0.85% in 2021. India experienced significant fluctuations in tariffs from both the US and EU, with EU tariffs oscillating from 2.02% in 2014 to 0% in 2016, and then rising again to 1.91% in 2019. Despite these variations, both markets imposed higher average tariffs on India compared to Vietnam, with 0.74% for the EU and 1.09% for the US.

³ These HS codes include: Machinery (HS code 84), Electrical Equipment (HS code 85), and one of Vietnam's fastest-growing exports, Furniture (HS code 94).

Figure 23: Tariff of European Union and United States for Machinery products (2014 – 2021)

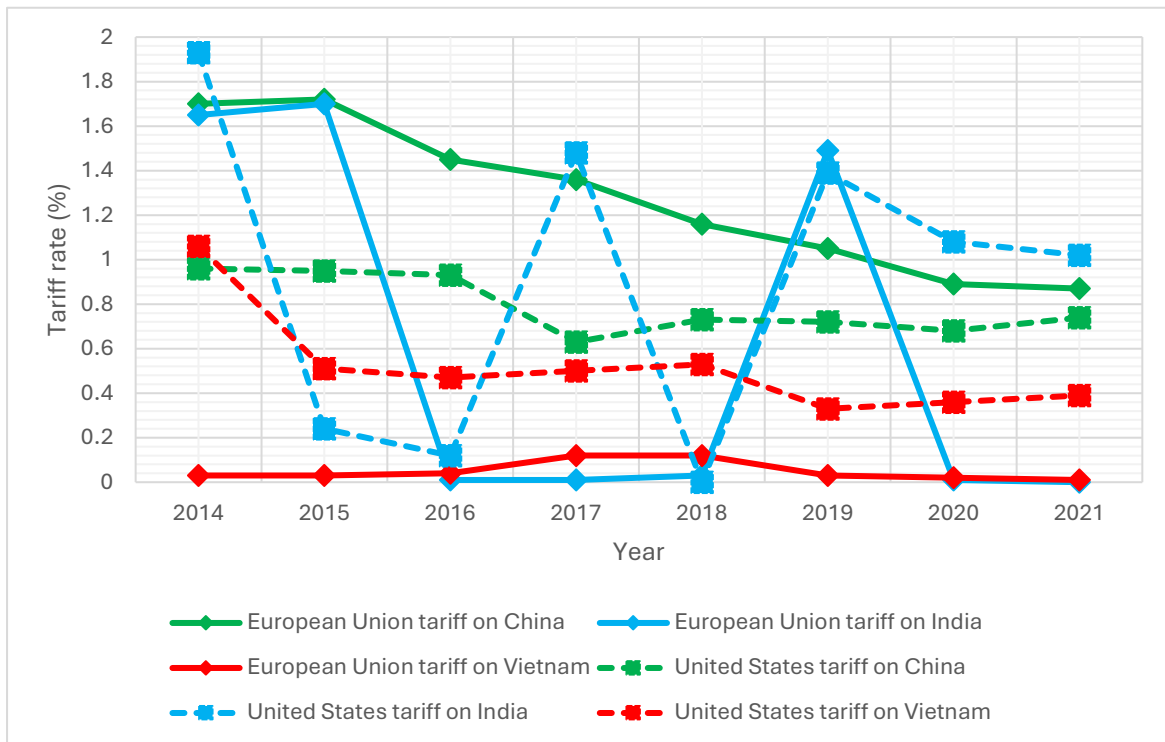


Source: Author’s design using Tariff data from UNCTAD TRAINS provided by World Integrated Trade Solution Data (World Bank & UNCTAD, 2024)

Tariffs imposed on electrical products by the US and EU mirror the trend observed in machinery. Indian products face significant tariff fluctuations but still endure a higher average tariff than Vietnam, with rates of 0.61% for the EU and 0.9% for the US. In contrast, Vietnam witnessed a notable decrease in the US market tariff rate from being higher than China's in 2014 to just 0.39% in 2021. Within the EU, Vietnam's tariffs have remained consistently lower than those of other countries, averaging at 0.05%. Despite a downward trend for both the US and EU markets, China's tariffs in 2021 still stood higher than Vietnam's at 0.74% in the US and 0.87% in the EU.

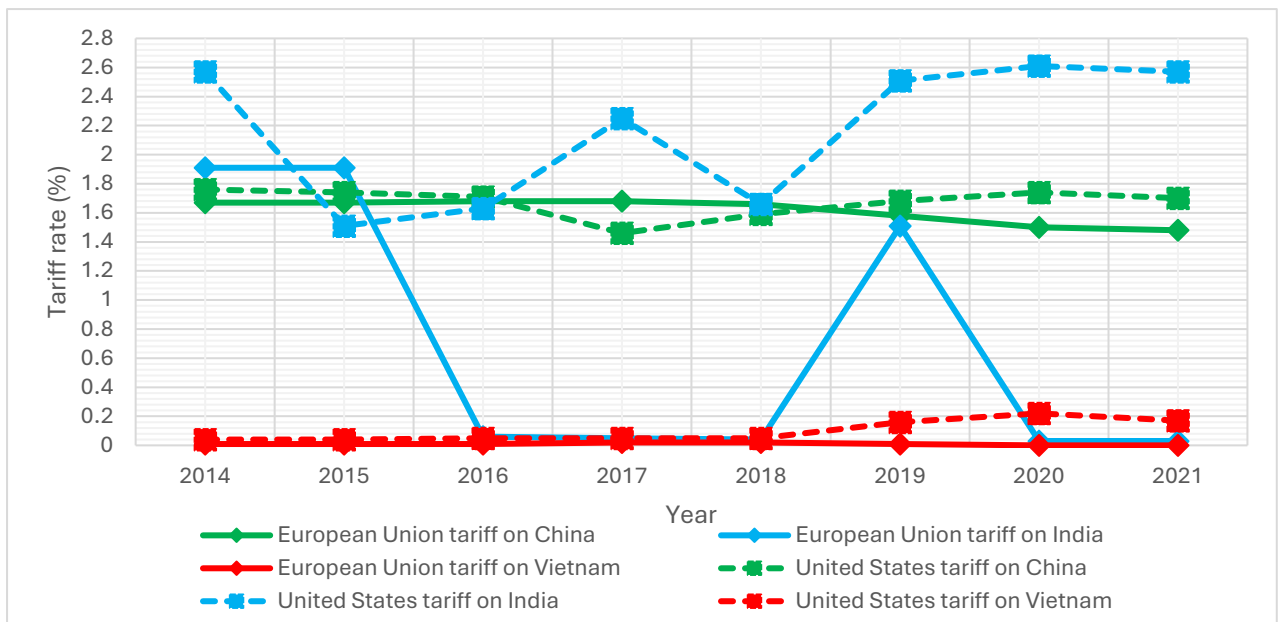
This pattern of competitive tariff rates extends to the furniture sector, where Vietnam's advantage is most pronounced. China's tariff rates hover around 1.65% for both the US and EU markets. For Indian furniture, the US imposes an average tariff of 0.69%, while the EU maintains a substantial 2.16% rate. In stark contrast, Vietnam's furniture products enjoy significantly lower tariffs, with average rates for both markets not exceeding 0.01%. This substantial differential in tariff rates could potentially serve as one of the key drivers behind the remarkable expansion of Vietnam's furniture manufacturing sector during this period.

Figure 24: Tariff of European Union and United States for Electrical products (2014 – 2021)



Source: Author's design using Tariff data from UNCTAD TRAINS provided by World Integrated Trade Solution Data (World Bank & UNCTAD, 2024)

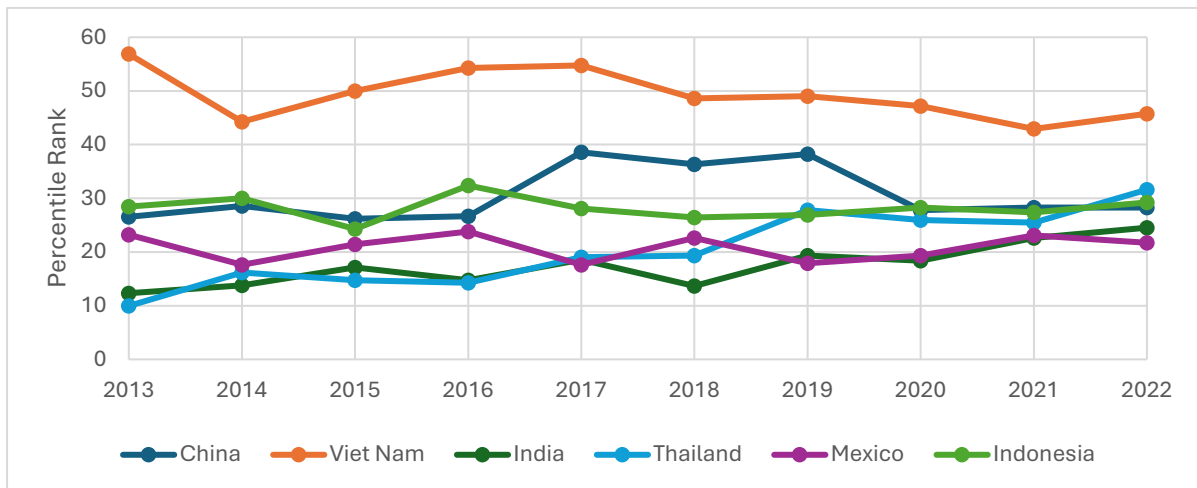
Figure 25: Tariff of European Union and United States for Furniture products (2014 – 2021)



Source: Author's design using Tariff data from UNCTAD TRAINS provided by World Integrated Trade Solution Data (World Bank & UNCTAD, 2024)

Finally, political stability is another key factor enhancing Vietnam's appeal to foreign investors. Rashid et. al. (2017) identified political stability as the most critical determinant influencing FDI inflows, outpacing other factors such as growth prospects, trade openness, market size, and inflation rates. Despite a recent downtrend, Vietnam maintained a 45th percentile rank in 2022, positioning it above Thailand (31st percentile), Indonesia (29th percentile), China (28th percentile), and India (24th percentile). Within the ASEAN context, however, Vietnam trails behind Singapore, Brunei, Laos, and Malaysia in terms of political stability.

Figure 26: Political stability and absence of violence/terrorism (2013 – 2022)



Source: Author's design using World Development Indicators data (World Bank, 2023b)

Policy incentives

Beyond the existing advantages, such as a robust labor force and a conducive environment discussed above, the Vietnamese government has been actively implementing various policies to enhance the country's appeal to foreign investors. Indeed, Vietnam's strategic positioning in international trade and its openness to FDI are largely due to its proactive governmental policies, notably since the Doi Moi economic reforms began in 1986. These reforms marked a shift towards market-oriented policies, despite the country's socialist governance, demonstrating a strong commitment to integrating into the global economy.

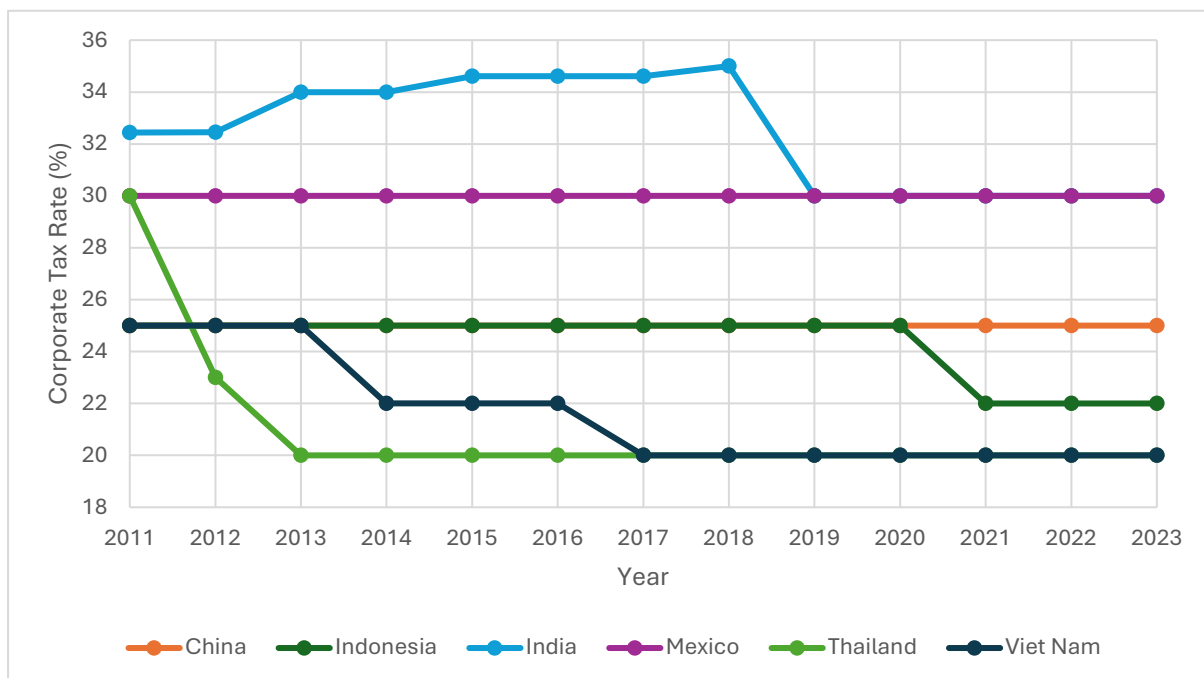
One pivotal factor influencing FDI is the corporate tax rate (CTR).⁴ Abdioğlu (2016) and Lesmana and Soetjipto (2022) argue that lower tax rates correlate with higher FDI levels. While various countries offer temporary tax exemptions for FDI firms, the CTR becomes a critical factor once these exemptions expire, as FDI firms then face the standard tax rate. Additionally, CTR impacts the operational costs of other firms in the country that the FDI firms may have to do business with, especially local firms.

Vietnam has made notable adjustments to its corporate tax policy, reducing the rate from 25% in 2011 to 22% in 2014, and further to 20% in 2017, where it has remained since. This adjustment positions Vietnam as tied for the third lowest corporate tax rate in Southeast

⁴ The impact of CTR on FDI incentives remains debated. For example, Jensen (2012) finds no significant correlation between FDI and CTR.

Asia, alongside Thailand and Cambodia. Despite setting a lower corporate tax rate at 18.5%, Brunei relies heavily on natural gas and does not directly compete with Vietnam for manufacturing sector. Singapore, however, poses a more direct challenge, with its 17% tax rate, especially in the electrical manufacturing sector, which is Singapore’s largest industry, accounting for about 25% of the country's GDP and 20% of its workforce (ASEAN briefing, 2024). Despite this competition, the rapidly growing FDI from Singapore to Vietnam (as demonstrated in the previous section) suggests a relationship that is more complementary than competitive. In a wider international context, Vietnam's tax regime stands out as particularly attractive. Both India and Mexico have maintained a CTR of 30% since 2019, and China's rate has been steady at 25% since 2019, and China's rate has been steady at 25% since 2011. Therefore, Vietnam's favorable tax rate offers compelling incentives for international firms looking to establish or expand their operations in the country.

Figure 27: Corporate Tax Rate (2011 – 2023)



Source: Author’s design using World Development Indicators data (World Bank, 2023b)

Along with the low corporate tax rate, Vietnam also utilizes specific tax incentives for FDI or highly profitable firms. These targeted incentives are designed to attract investment in key areas, promoting technological advancement and economic development in sectors critical to Vietnam’s industrial strategy. For example, Circular No. 78/2014/TT-BTC detailing and guiding the implementation of the Law on Enterprise Income Tax stipulates cases when a reduced tax is used instead of the normal flat tax rate when the firm satisfies some criteria:

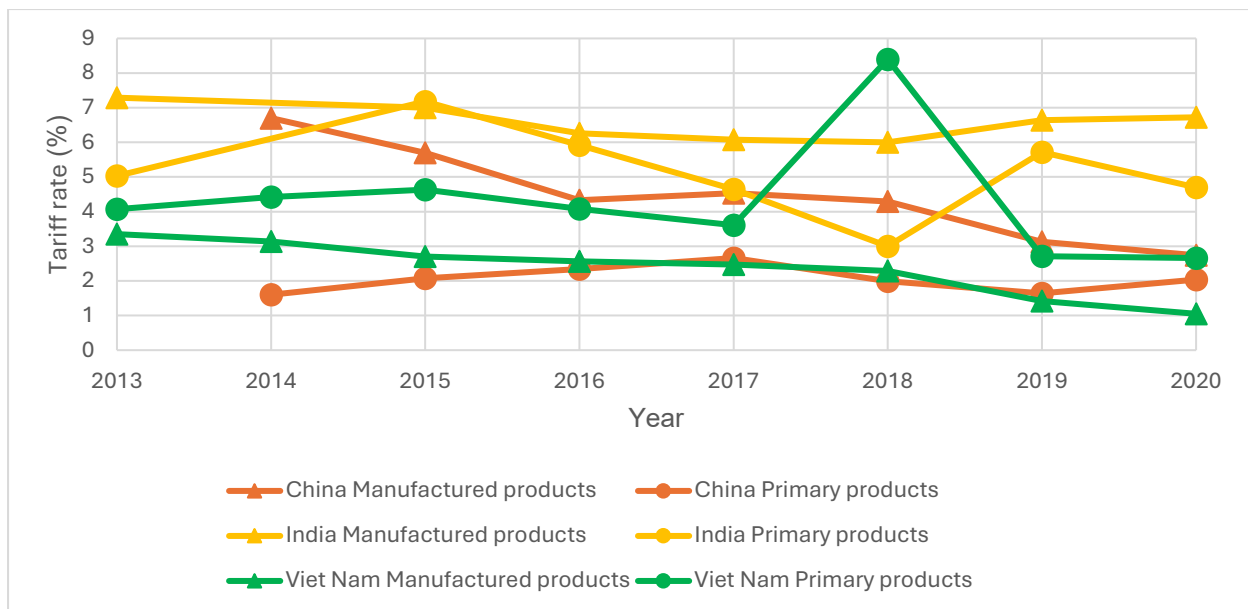
- **Enjoy preferential tax rate of 10% in 15 years** for (i) firms located in Economic Zone, High-tech Park; (ii) High-tech firms; (iii) Manufacturing firms that have a minimum initial registered investment capital of VND 6 trillion and either have a total

revenue of VND 10 trillion or frequently employ 3.000 or more people; (iv) Manufacturing firms that have a minimum initial registered investment capital of VND 12 trillion and using technologies approved by the law; (v) Manufacturing firms with industrial products that support high technologies and other manufacturing industries (apparels, footwears, electrical, machinery). **Firms in this category also enjoy a tax exemption for four years and a 50% reduction in tax payable for the next nine years.**

- **Enjoy preferential tax rate of 17% in 10 years for** (i) firms located in areas with difficult socio-economic conditions; (ii) firms that manufacture high-quality steel, energy-saving products, machinery, and equipment for agricultural, forestry, fishery, and salt production; manufacturing and refining food for livestock, poultry, and aquaculture; develop traditional industries.

Vietnam complements its attractive corporate tax incentives for FDI firms with additional benefits through reduced tariffs on imports and exports. The low tariff rates are crucial for minimizing the costs associated with importing raw materials, intermediate inputs and capital needed for production and scientific research. Vietnam has introduced several import and export tariff incentives, such as: (i) import tariff exemption for goods imported for processing; and (ii) import tariff exemption for goods used to create fixed assets for investment projects in prioritized investment areas (Minh, 2020).

Figure 28: Tariff rate, applied, weighted mean, for manufactured products and primary products for China, India, and Vietnam (2013 – 2020)



Source: Author’s design using World Development Indicators data (World Bank, 2023b)

Reflecting this policy's impact, the import tariff rate for primary products decreased from 4.07% in 2013 to 2.66% in 2020, and for manufactured goods, the reduction was even more significant, from 3.35% to 1.05%. Besides the conscious effort by the Vietnamese government, this aspect can also be seen as an advantage of a favorable environment,

especially in the case of India. Under its "Make in India" initiative, India imposes higher tariff rates on imports than Vietnam, with 6.72% on foreign manufactured products and 4.7% on primary products. Mukherjee (2023) highlighted that by increasing the duty on printed circuit board assembly and displays by 11 percentage points, India inadvertently introduced a 4% cost disadvantage for its manufactured mobile phones.

Table 2: Land Rent Policies Aimed at Attracting Investment in Vietnam (As of December 2023)

No.	Policy Content	Applicable Duration/Rate
1	Reduction of the rate for calculating land rental prices for large-scale investment incentive projects	From 0.5% to 3%
2	Land rent exemption for specific investment projects in the list of industries and occupations with special investment incentives (except for construction and business of infrastructure in economic zones)	Total exemption
3	Land rent exemption for concentrated housing construction projects for workers and laborers in economic zones	Total exemption
4	Land rent exemption for public service construction projects of public service organizations in the Economic Zone	Total exemption
5	Land rent exemption for projects to build maintenance and repair stations, and car parking lots to serve public passenger transport activities following the law on road transport	Total exemption
6	Land rent exemption for water supply construction projects, including water abstraction and treatment, pipelines, projects on the water supply pipeline network, projects supporting management and operation of water supply system	Total exemption
7	Duration of land rent exemption during the basic construction period	3 years
8	Duration of land rent exemption after the initial exemption period for projects not on investment incentive categories	13 years
9	Duration of land rent exemption after the initial exemption period for projects on investment incentive categories	17 years
10	Duration of land rent exemption after the initial exemption period for land leased by the State for investment in construction and business of functional area infrastructures	15 years

Source: Draft Report Reviewing the Overall Assessment of Investment Incentive Policies (Ministry of Planning and Investment, 2023)

Vietnam's approach to attracting FDI also includes offering generous subsidies for land rent (Table 2). The Vietnamese government provides a wide array of incentives in this regard, particularly through significant exemptions and reductions in land rent for the lifetime of the project or for a predetermined period. Between 2011 and 2014, Vietnam cut the total land rent by 50% (Minh, 2020), and it also revised the standard land rental rate from 1.5% to 1%

(Decree 121/2010/NĐ-CP). For prioritized sectors, this rate can be reduced further to as low as 0.5% (Decree 35/2017/ND-CP).

Table 3: Vietnam's Free Trade Agreements (As of August 2023)

AFTA	Effective since 1993	ASEAN
ACFTA	Effective since 2003	ASEAN, China
AKFTA	Effective since 2007	ASEAN, South Korea
AJCEP	Effective since 2008	ASEAN, Japan
VJEPA	Effective since 2009	Vietnam, Japan
AIFTA	Effective since 2010	ASEAN, India
AANZFTA	Effective since 2010	ASEAN, Australia, New Zealand
VCFTA	Effective since 2014	Vietnam, Chile
VKFTA	Effective since 2015	Vietnam, South Korea
VN – EAEU FTA	Effective since 2016	Vietnam, Russia, Belarus, Armenia, Kazakhstan, Kyrgyzstan
CPTPP (previously known as TPP)	Effective since 30/12/2018, it came into effect in Vietnam since 14/01/2019	Vietnam, Canada, Mexico, Peru, Chile, New Zealand, Australia, Japan, Singapore, Brunei, Malaysia, and The UK (signed the Accession Protocol on July 16, 2023)
AHKFTA	Effective in Hong Kong (China), Laos, Myanmar, Thailand, Singapore and Vietnam since 11/06/2019	ASEAN, Hongkong (China)
EVFTA	Effective since August 01, 2020	Vietnam, EU (27 members)
UKVFTA	Effective since May 01, 2021	Vietnam, The UK
RCEP	Effective since January 01, 2022	ASEAN, China, Korea, Japan, Australia, New Zealand
VIFTA	Negotiations commenced in December 2015, completed in April 2023. Officially signed on 25/07/2023	Vietnam, Israel

Source: Vietnam's FTAs as of August 2023 (Center for WTO and International Trade, 2023)

Finally, Vietnam has been a member of various multilateral and bilateral free trade agreements, starting with its participation in the ASEAN Free Trade Area (AFTA) in 1993, and leading to its accession to the World Trade Organization (WTO) in 2007. As of August 2023, Vietnam is a party to 16 Free Trade Agreements (FTAs), with three additional FTAs

under negotiation (Vietnam – EFTA FTA, ASEAN – Canada, and Vietnam – UAE FTA)⁵. Moreover, Vietnam has established a "Comprehensive Strategic Partnership"—the highest level of diplomatic relations—with seven countries (China, Russia, India, Korea, the United States, Japan, and Australia), with Australia becoming the most recent addition in March 2024. These efforts have not only helped lower tariff rates but also positioned Vietnam as a welcoming and promising destination for foreign direct investment.

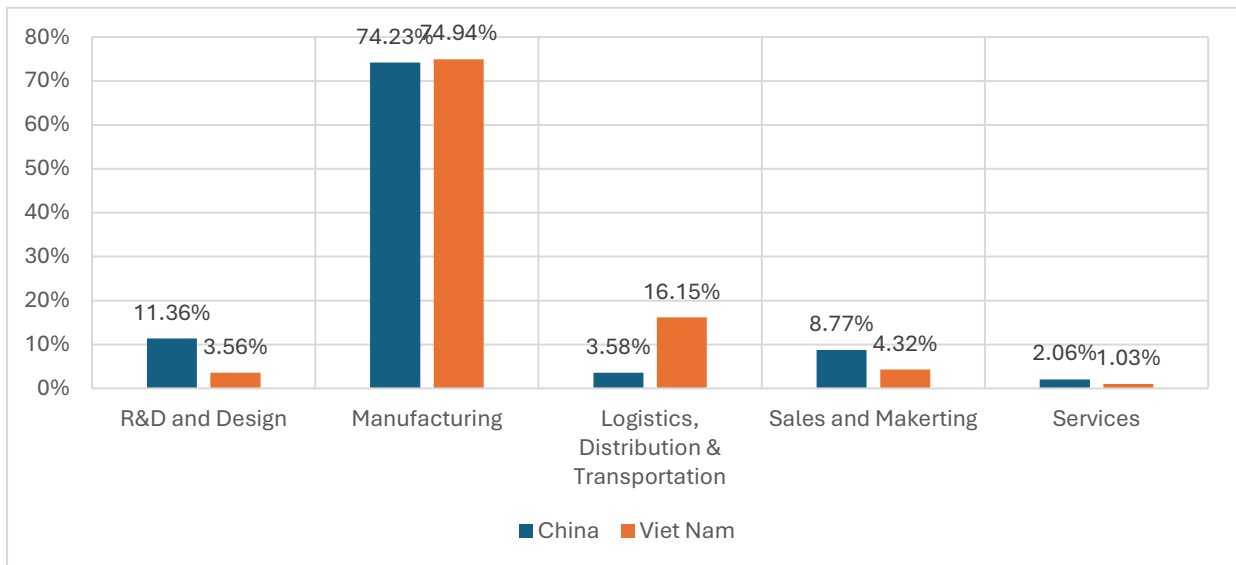
IV. High FDI inflows, low value: the export paradox

Although Vietnam has attracted substantial foreign direct investment, its exports remain relatively low in value-added. A significant portion of the country's manufacturing sector, particularly in electronics and textiles, continues to depend on imported raw materials and intermediate inputs, often sourced from regional supply chains anchored in China. As a result, while foreign investment has increased export volumes, the share of domestically created value remains modest. This section explores the value-added component of Vietnam's exports across various manufacturing industries.

Drawing on data from the Orbis Greenfield FDI database, 74.23% of FDI inflows into China and 74.94% into Vietnam are directed toward manufacturing, reflecting the sector's central role in both countries. However, China attracts significantly more investment in higher-value stages close to the production end, with R&D and design investments more than triple those in Vietnam (11.36% versus 3.56%). In contrast, Vietnam secures a larger share of logistics-related foreign investment—both as a proportion of total inflows (16.15% versus 3.58%) and in capital value (USD 2.8 billion versus USD 2 billion). This discrepancy may be due to China's already well-established logistics and transportation infrastructure, which curbs the need for additional investment in that area. In other high-value sectors, including retail and services, China again outperforms Vietnam, underscoring its broader emphasis on the higher-value-added segments of the "Smile Curve." Overall, while manufacturing remains a primary draw for both countries, China garners more investment in most of the higher-value-added phases of the value chain, with logistics being the notable exception in Vietnam's favor.

⁵ **Vietnam - EFTA FTA:** Negotiations commenced in May 2012, consisting of Vietnam and EFTA (Switzerland, Norway, Iceland, Liechtenstein). **ASEAN – Canada FTA (ACaFTA):** The ACaFTA agreement officially began negotiations at the 10th ASEAN-Canada Economic Ministers' Consultation in November 2021, consisting of ASEAN and Canada. **Vietnam – UAE FTA:** In 2023, Vietnam and the UAE have concluded negotiations on most of the contents of the Agreement and are expected to end negotiations soon in 2024.

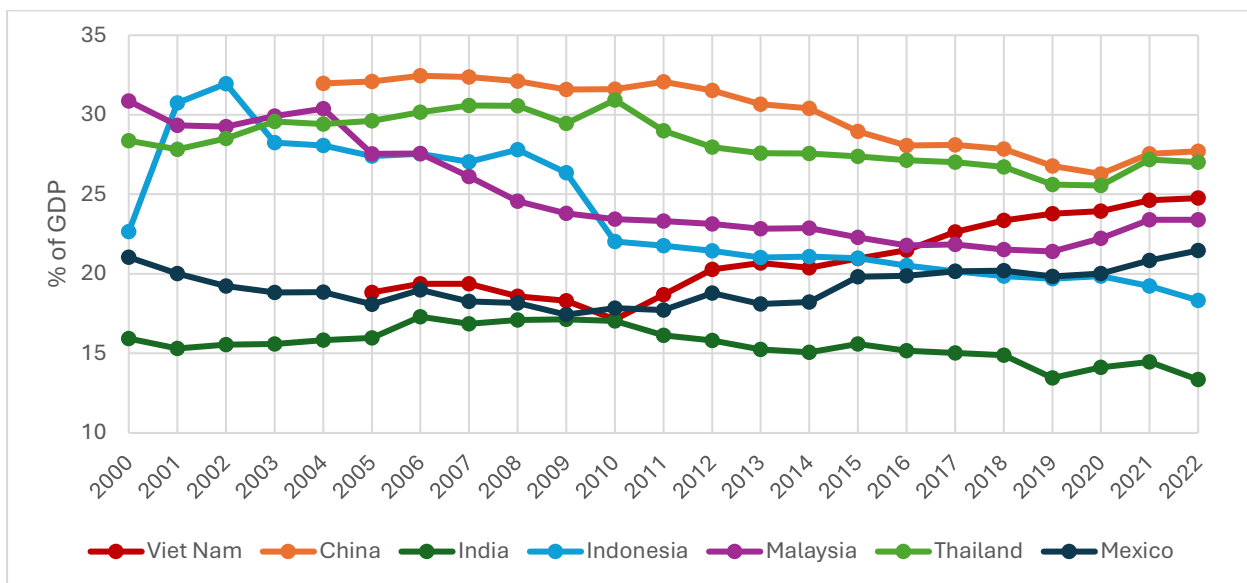
Figure 49: FDI Projects in Vietnam and China, by sector (2013-2023)



Source: Author's design using Orbis Greenfield FDI

High FDI inflows into Vietnam's manufacturing sector are reflected in the rising share of manufacturing value added within Vietnam's total GDP—an upward trajectory that contrasts with declines observed in other ASEAN nations (Figure 30). Vietnam's manufacturing share began at 18.82% in 2005, dipped slightly from 2008 to 2010 amid the global financial crisis, and then climbed steadily from 2011 onwards. By 2022, this figure reached 24.76%; if the trend continues, Vietnam may soon surpass China, whose manufacturing share stood at 27.70% of GDP in 2022. This development diverges from the global pattern, where manufacturing's contribution to GDP has remained fairly stagnant, hovering around 16–17% over the past two decades.

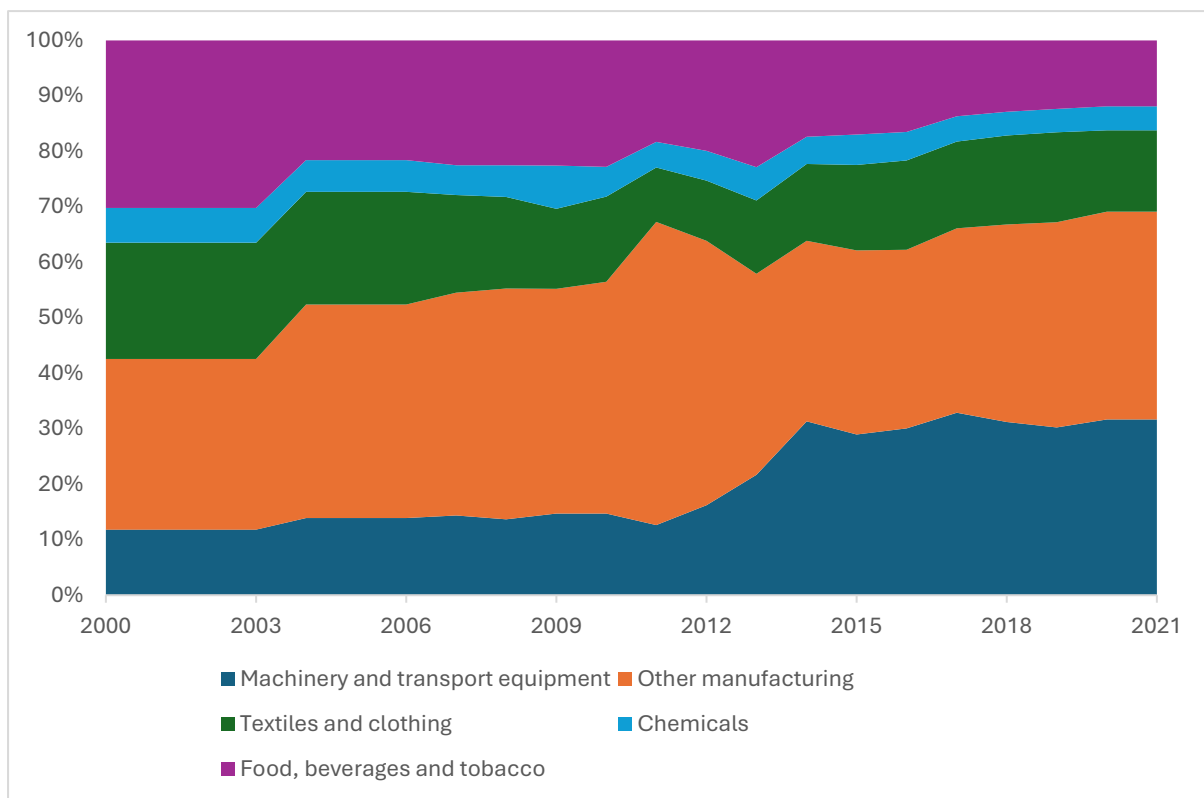
Figure 30: Manufacturing, value added (% of GDP) (2000 – 2021)



Source: Author's design using World Development Indicators data (World Bank, 2023b)

A breakdown of total value added in the manufacturing sector reveals that machinery and transport equipment posted the strongest growth. Their share, which was 11.81% in 2000, remained relatively stable over the following decade and then surged from 2011 onward, reaching 31.69% by 2020. Despite this increase, other manufacturing retained the largest overall share at 37.43% in 2020, though this was down from its peak of 54.68% in 2011.⁶ Another notable change during this period was the decreasing importance of the food, beverage, and tobacco industries. These industries once contributed nearly one-third of the total value added (30.19%), but by 2020, their contribution had dropped to around 11.87%. This decrease can be attributed to technological advancements favoring medium and high-tech industries as dominant contributors. While value added in the food, beverage, and tobacco industries still increased in absolute terms, they could not keep pace with the growth of the former sectors.

Figure 31: Industries share of value added in manufacturing of Viet Nam (2000 – 2021)



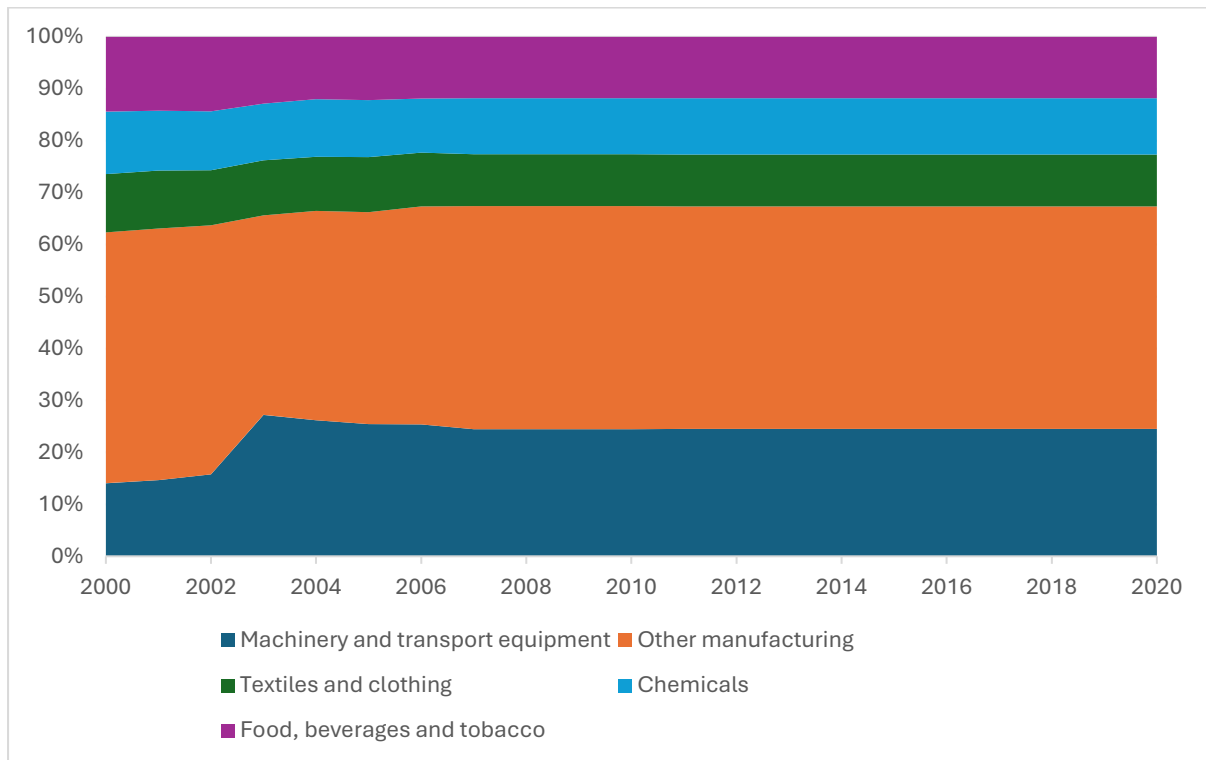
Source: Author's design using World Development Indicators data (World Bank, 2023b)

Contrary to Vietnam, China's composition of value added remained virtually unchanged from 2000 to 2020. The only notable change in the share of industries occurred in 2003 when machinery and transport equipment increased from 15.78% to 27.21%, leading to a subsequent decrease in the share of other manufacturing industries. This could indicate that China, as a more mature economy, has developed its industries into relatively stable

⁶ Other manufacturing includes ISIC divisions 20-23, 25-28, 31, 33, 36, and 37, with notable products such as furniture (ISIC division 36) and electrical machinery and apparatus (ISIC division 31).

positions. However, China shares a similarity with Vietnam in that "other manufacturing" also contributed the largest share of value-added, accounting for 42.84% in 2020.

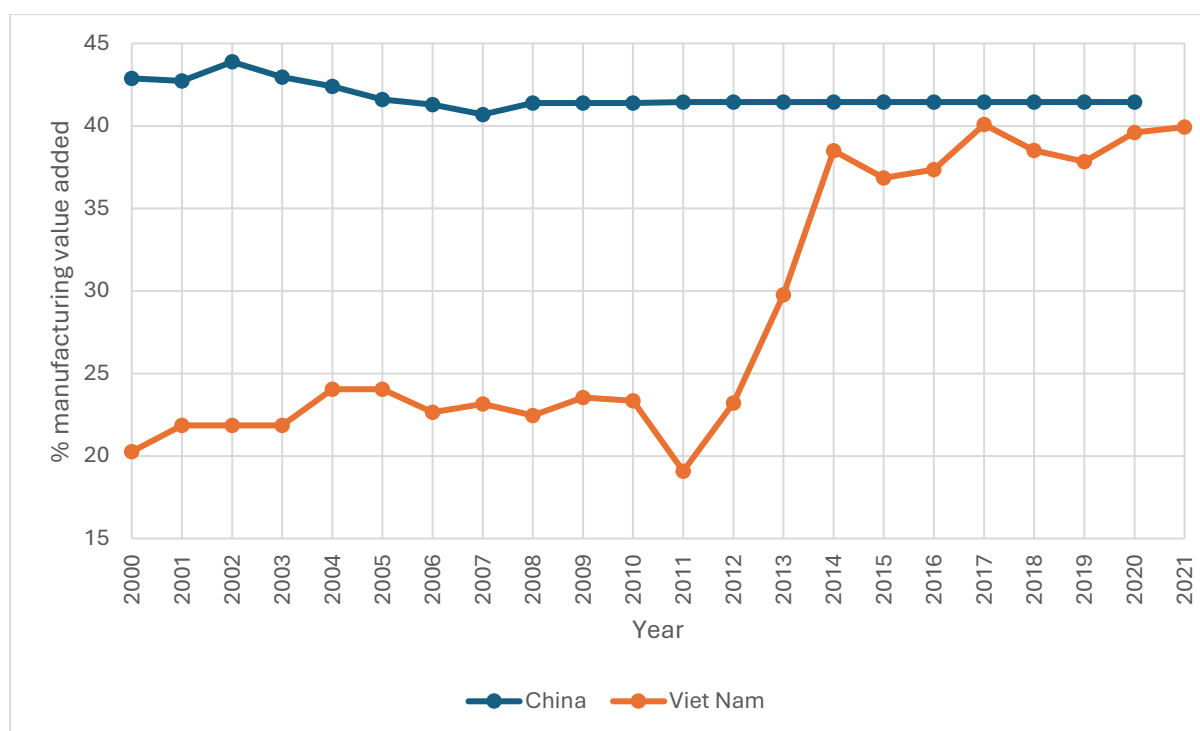
Figure 32: Industries share of value added in manufacturing of China (2000 – 2020)



Source: Author’s design using World Development Indicators data (World Bank, 2023b)

Another indicator that highlights the development of the manufacturing sector is the share of value added from medium and high-tech industries. As shown in Figure 33 below, we observed that Vietnam had a low contribution from medium and high-tech manufacturing industries from 2000 to 2011, fluctuating only around 20–25% of the total value added in manufacturing. However, within just three years from its all-time low in 2011 (19.08%), Vietnam significantly enhanced its technological capabilities in manufacturing, with a 20 percentage point increase to nearly 40% contribution (38.50%). After this period, Vietnam's growth rate slowed slightly, reaching 39.61% in 2020.

Figure 33: Medium and high-tech manufacturing value added (% manufacturing value added) (2000 - 2021)



Source: Author's design using World Development Indicators data (World Bank, 2023b)

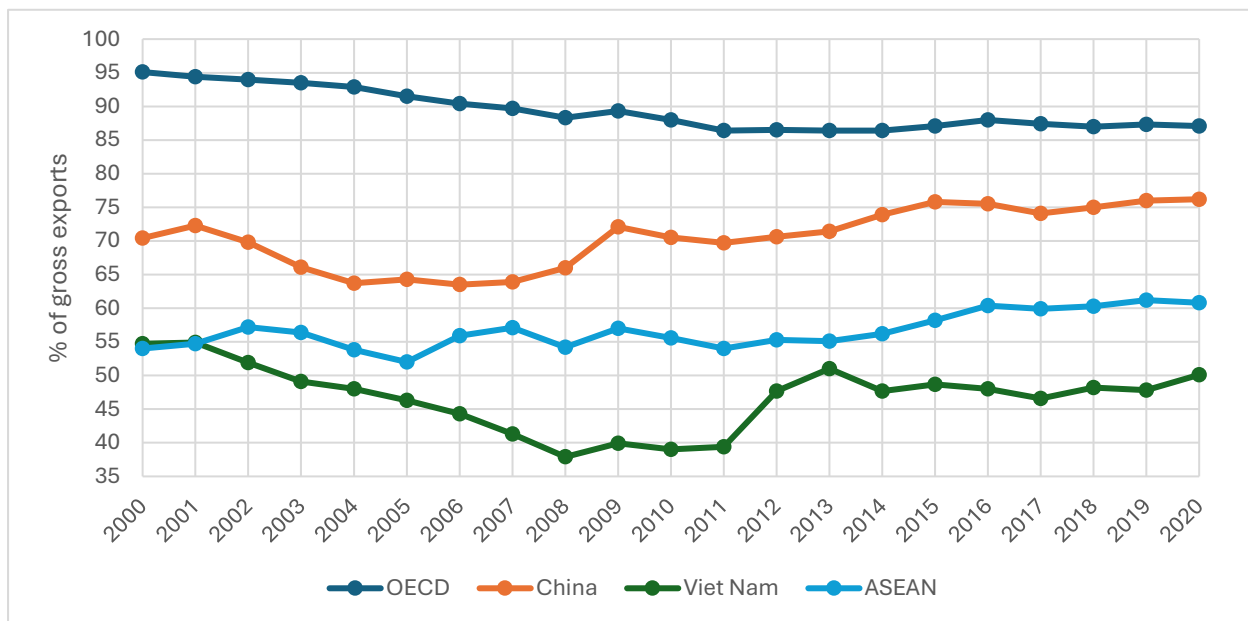
Trinh (2015), in their research on whether Vietnam is increasingly relying on imported products to support its export growth, took a neutral stance on the domestic content of value-added, stating that "the share of domestic content in exports of products may not necessarily require higher priority than the gross amount of domestic value added from exports" (Trinh, 2015). However, contrary to this stance, we emphasize domestic capabilities in our analysis. Our rationale is as follows: while Vietnam's value added in exports continues to grow in absolute terms, having low domestic content implies greater dependency on other countries for exports. Recent events, such as the Covid-19 pandemic, have highlighted the fragility of global supply chains and raised concerns over this dependency. For instance, when China closed its borders for quarantine, Vietnam's textile industry, which imports 89% of its materials with 55% from China, nearly came to a halt. Additionally, more developed economies typically exhibit higher shares of domestic value added. OECD countries, for example, average very high levels of domestic value-added, with no industry falling below 80% of total exports.

Although value-added in Vietnam's manufacturing sector continues to climb, a key challenge lies in the fact that much of this value creation takes place outside the country. This differs sharply from the higher proportion of domestic value-added found in OECD countries, China, and other ASEAN nations. The gap underscores Vietnam's ongoing struggle to bolster its local production capabilities and reduce dependence on imported components.

Among the four industries we analyzed, the electrical equipment manufacturing industry had the highest share of domestic value added in 2020 at 50.1%. It started at around 54% in 2000 and experienced a steady decline over the next eight years to 37.90% in 2008.

Interestingly, from 2008 to 2011, this decline halted, coinciding with the 2008 Global Financial Crisis. The period from around 2011 to 2013 saw the most significant growth in Vietnam's domestic value-added, increasing back to 51.00% within just two years. Following this peak, domestic content in Vietnam experienced a slight decrease and remained around that level until 2020.

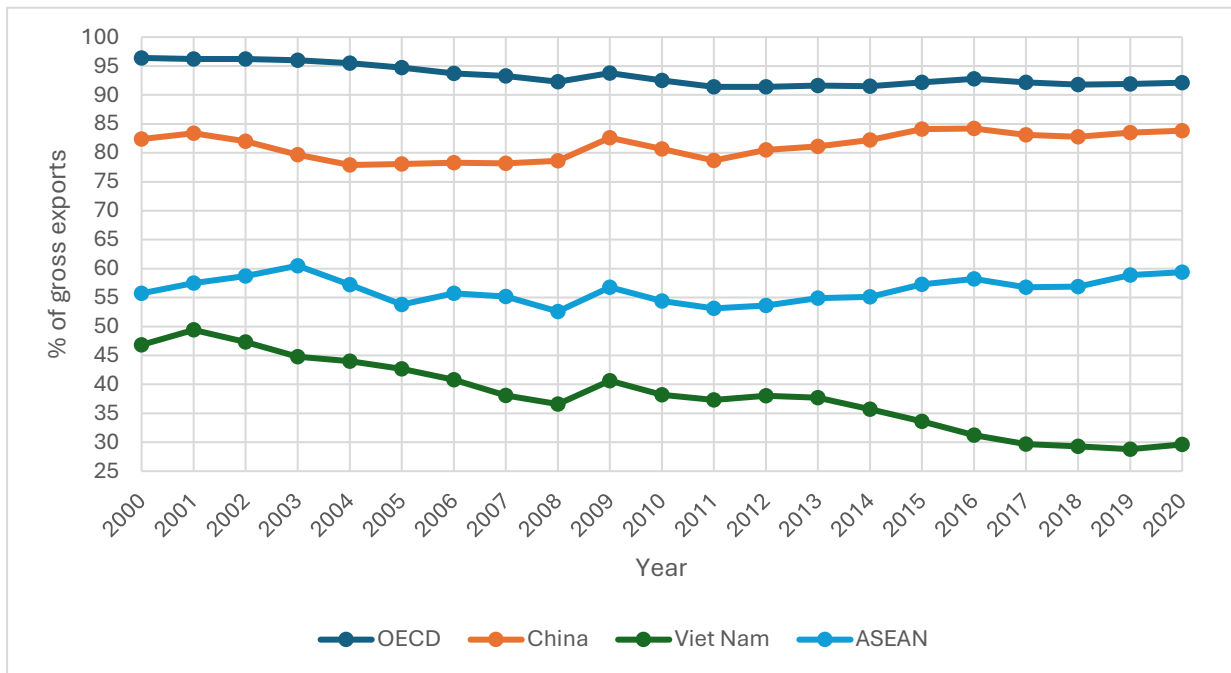
Figure 34: Domestic value added in gross exports of electrical equipment (2000 – 2020)



Source: Author’s design using Trade in Value Added data - 2023 editions (OECD, 2023b)

Surprisingly, machinery and equipment was the industry with the lowest rate of value added in Vietnam in 2020, accounting for only 29.60% of the total export value generated domestically. OECD countries, despite experiencing a downward trend, consistently maintained the highest percentage of domestic value-added, remaining above 86% throughout the period. China followed in second place; despite a decline from 2001 to 2009, they steadily increased from 2010 onward, reaching nearly 80% in recent years. ASEAN countries also showed a fluctuating trend, starting at 54% in 2000, experiencing slight dips, and gradually increasing to 61% by 2020.

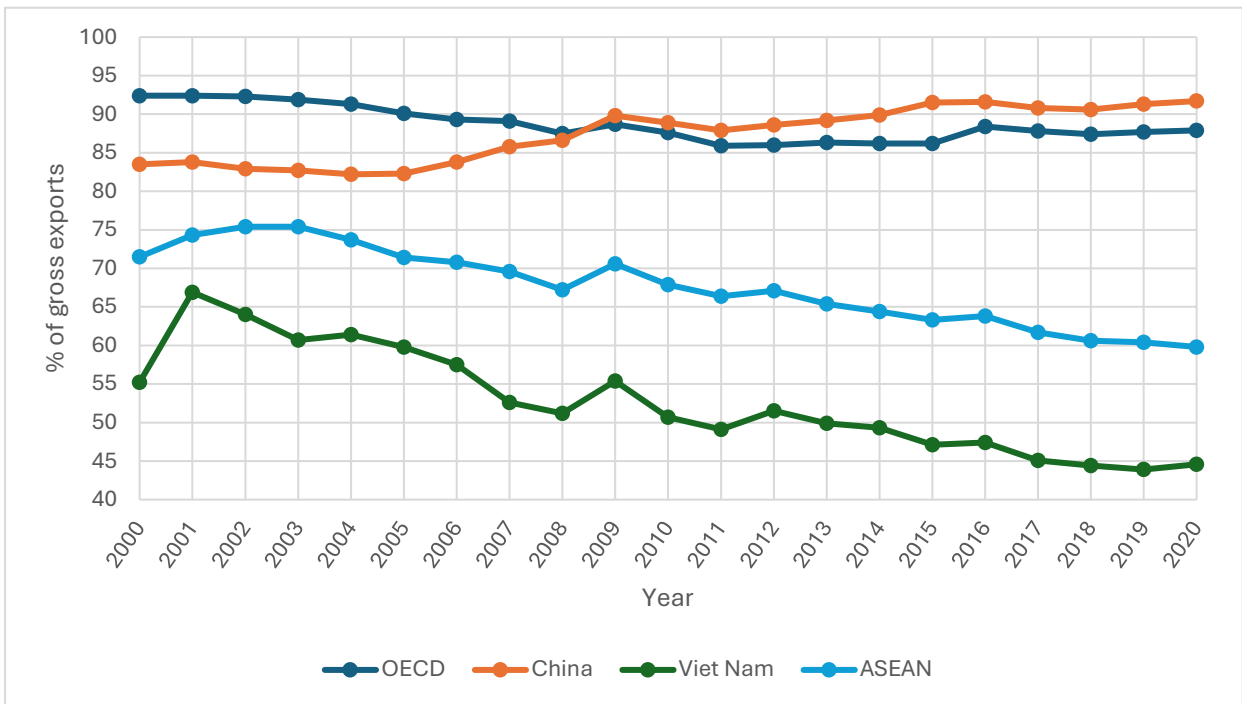
Figure 35: Domestic value added in gross exports of machinery and equipment (2000 - 2020)



Source: Author’s design using Trade in Value Added data - 2023 editions (OECD, 2023b)

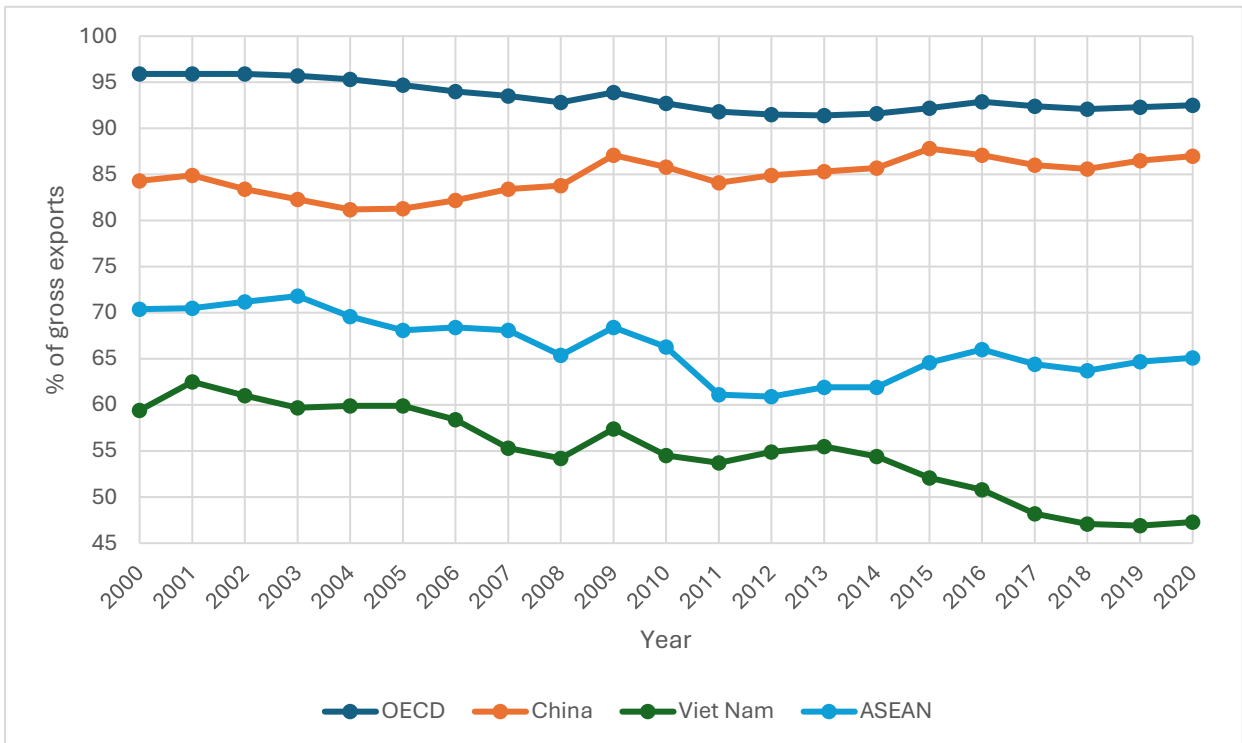
The remaining two industries, textiles and wearing apparel, as well as furniture, also reveal a consistent pattern of declining domestic value added in Vietnam's exports. For textiles and wearing apparel, the domestic content fell sharply from a peak of 66.9% in 2001 to 44.6% in 2020. Similarly, in the furniture industry, Vietnam's domestic value-added percentage started at around 60% in 2000 but decreased steadily over the years to 47.3% by 2020. In the textiles industry, China surpassed OECD countries in domestic value added from 2009 onwards, showing an increasing trend, while OECD countries experienced a slight decline. The ASEAN countries exhibit a decline but remain higher than Vietnam in both industries.

Figure 36: Domestic value-added in gross exports of textiles, wearing apparel (2000 - 2020)



Source: Author's design using Trade in Value Added data - 2023 editions (OECD, 2023b)

Figure 37: Domestic value added in gross exports of furniture (2000 - 2020)

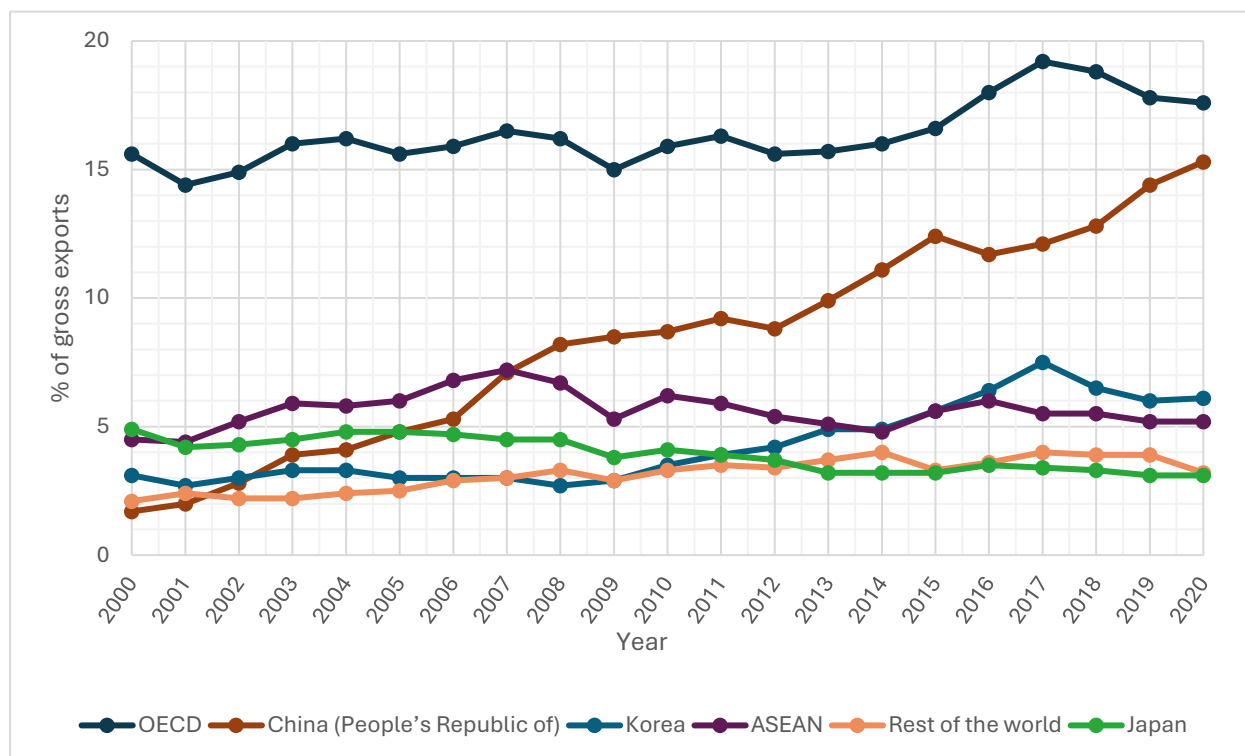


Source: Author's design using Trade in Value Added data - 2023 editions (OECD, 2023b)

As the analysis indicates, Vietnam remains heavily reliant on other countries for its export activities, whereas China has significantly upgraded its capabilities and moved into

higher tiers of the value-added chain. Examining the share of foreign contributions to Vietnam’s total exports reveals that, initially, the OECD held the largest portion, accounting for 17.6% of Vietnam’s gross exports in 2020 (equivalent to 36.67% of all foreign value added). Yet China’s role in Vietnam’s exports has expanded the most dramatically. Over the last 20 years, China’s contribution to Vietnam’s gross exports grew from 1.7% to 15.3%, constituting 30.10% of foreign value added. This surge is especially notable given that the OECD includes 38 advanced economies, such as South Korea, Japan, and the United States. Within the OECD, South Korea stands out as the second-largest contributor to Vietnam’s exports, largely fueled by its foreign direct investment in the country.

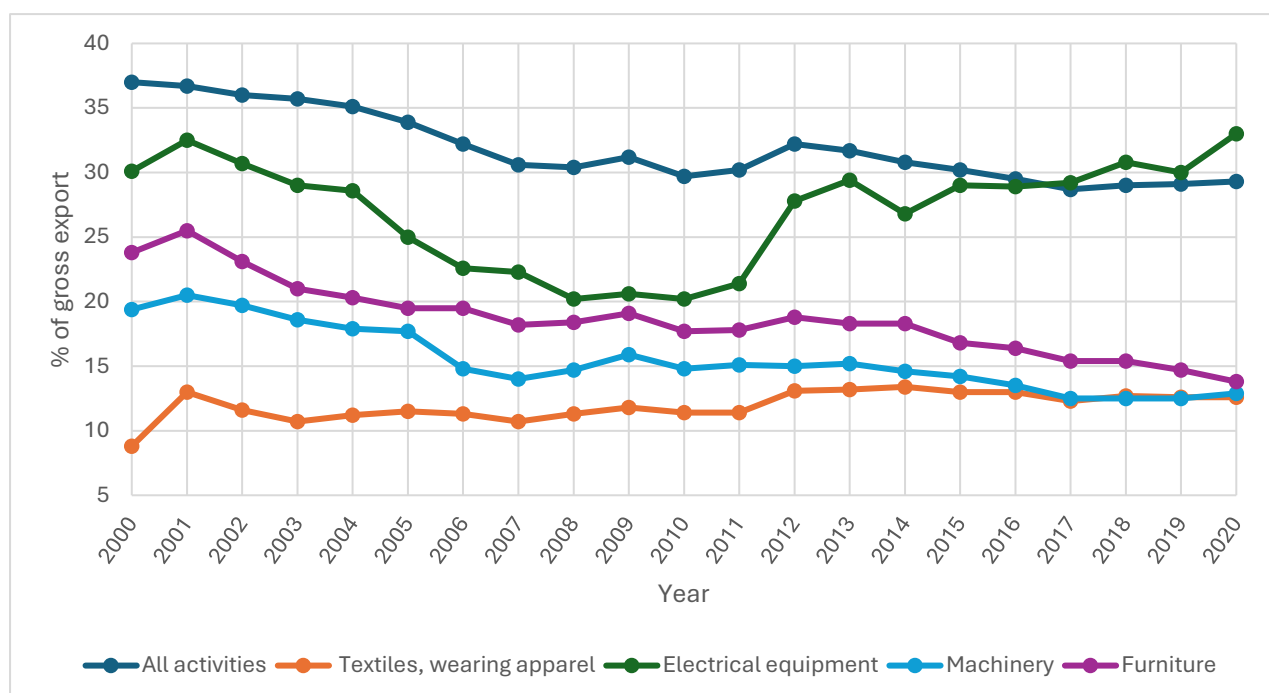
Figure 38: Foreign value-added in gross exports, by origin partner shares (2000 – 2020)



Source: Author’s design using Trade in Value Added data - 2023 editions (OECD, 2023b)

We then turned our attention to Vietnam’s domestic value-added in its exports of both intermediate products and final goods. In general, developed economies tend to emphasize capturing more of their value added in final goods rather than supplying intermediate inputs that are processed elsewhere. When it comes to Vietnam’s intermediate products (Figure 39), there has been a downward trend in the share of domestic value-added—from 37% in 2000 to 29.3% in 2020. Within specific industries, textiles and apparel increased from 8.8% in 2000 to 12.6% in 2020, while electrical equipment rose from 30.1% to 33% in the same period. In contrast, machinery declined from 19.4% in 2000 to 12.9% in 2020, and furniture dropped from 23.8% to 13.8%.

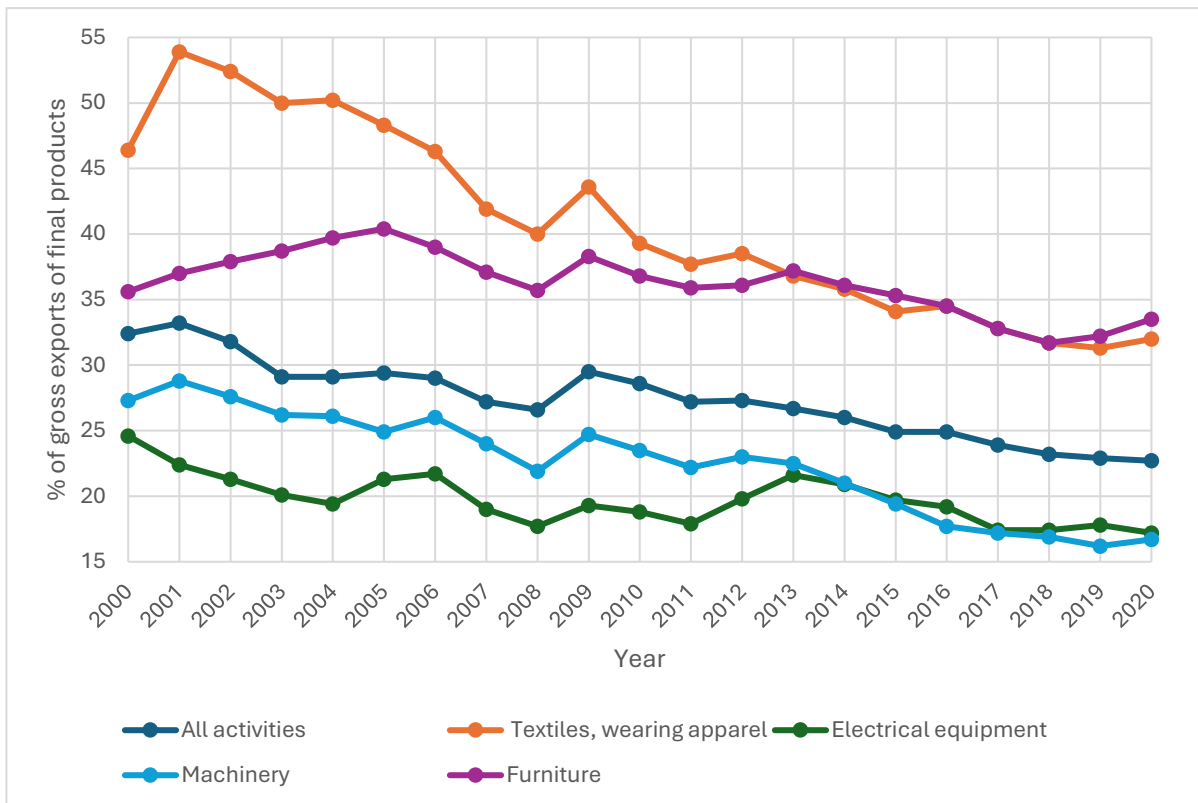
Figure 39: Domestic value-added in Vietnam’s gross exports of intermediate products
(Percentage of gross exports) (2000 – 2020)



Source: Author’s design using Trade in Value Added data - 2023 editions (OECD, 2023b)

Similarly, Vietnam’s domestic value-added in final product exports also declined (Figure 40). Notably, the electrical equipment and machinery industries—which have relatively higher domestic value-added in intermediate exports—rank among the lowest in domestic value-added for final exports. As of 2020, only 17.2% of electrical equipment and 16.7% of machinery domestic value-added went into final products. By contrast, textiles, apparel, and furniture—while contributing a comparatively smaller value-added in intermediate exports—led in terms of domestic value-added in final products, at 32.0% and 33.5%, respectively, in 2020. However, textiles and apparel also experienced the steepest drop in this metric, falling from a high of 53.9% in 2001.

Figure 40: Percentage of domestic value-added in Vietnam’s gross exports of final products (2000 - 2020)

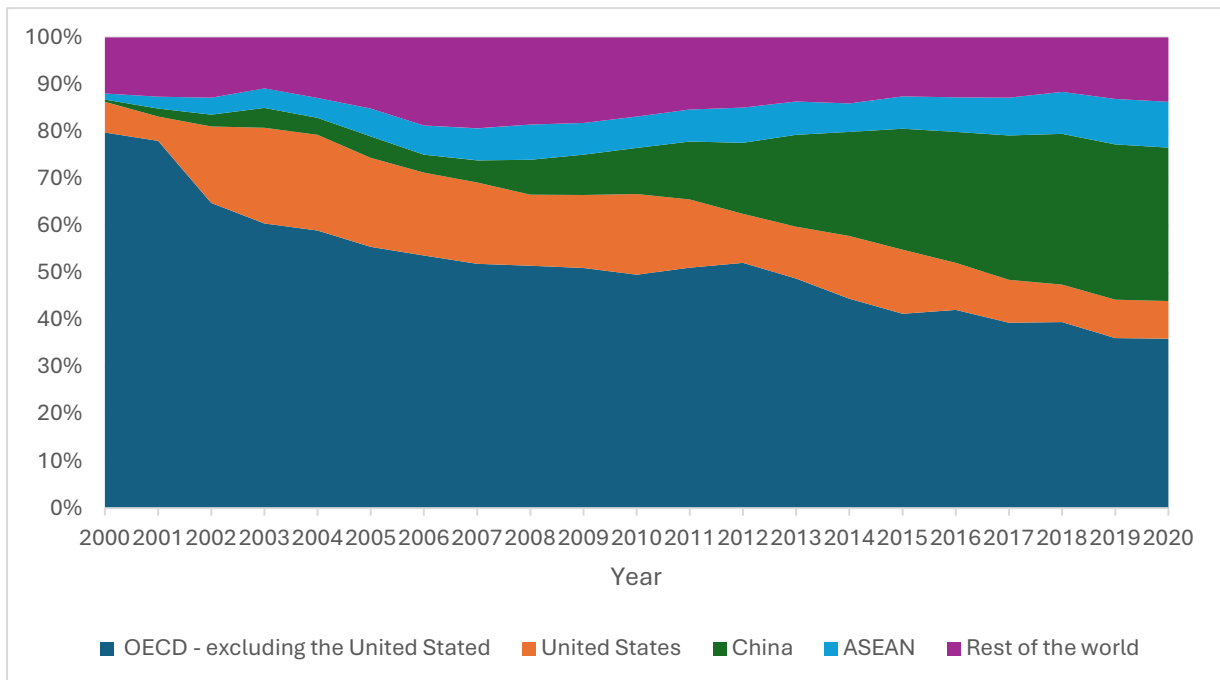


Source: Author’s design using Trade in Value Added data - 2023 editions (OECD, 2023b)

In terms of destinations of Vietnam’s domestic value-added in intermediate exports, China has emerged as the leading destination across various industries.

For the textiles sector, the OECD used to be the major destination for Vietnam’s textile intermediates. However, its share declined substantially from about 79.8% in 2000 to 36% in 2020. The United States also experienced a reduction in its share from around 25% to 15% over the same period, indicating a lower reliance on Vietnamese textile intermediates. Meanwhile, China’s share rose dramatically from a marginal 0.5% in 2000 to approximately 32.6% by 2020, making it the largest single destination. Although ASEAN’s share remained relatively small, it followed a generally upward trend, moving from 1.30% in 2000 to 9.70% by 2020. The rest of the world remained relatively stable, ranging between 11% and 13% and peaking briefly at 19.3% in 2007.

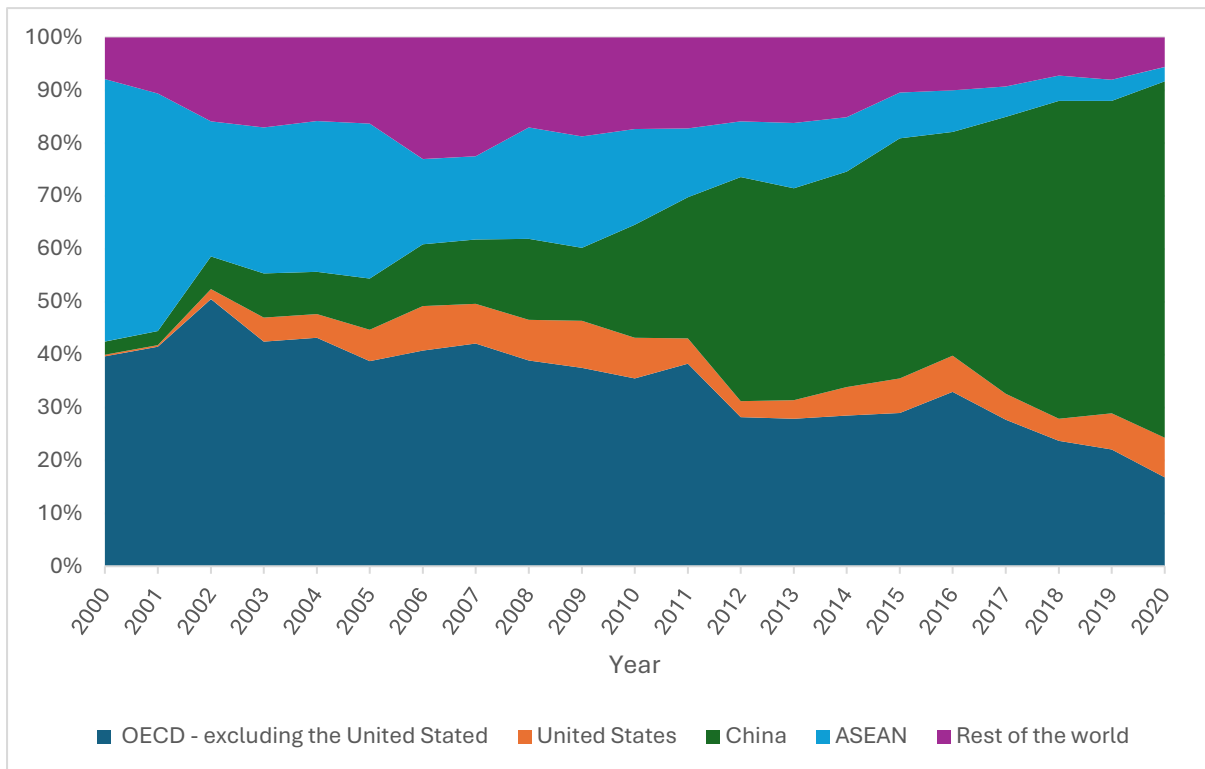
Figure 41: Vietnam’s domestic value-added in its gross exports of intermediate products in textiles industry, destination partner shares (2000 – 2020)



Source: Author’s design using Trade in Value Added data - 2023 editions (OECD, 2023b)

In the Vietnam’s intermediate exports in electrical equipment industry, China exerts a dominant role in Vietnam’s supply chain. Its share skyrocketed from 2.5% in 2000 to 67.39% in 2020, far exceeding the combined share of all OECD economies, which declined from 40.00% to 24.30% in the same period. Meanwhile, ASEAN’s share dropped sharply from 49.60% to 2.70% by 2020, signaling a decoupling of Vietnam’s electrical intermediates from regional trade.

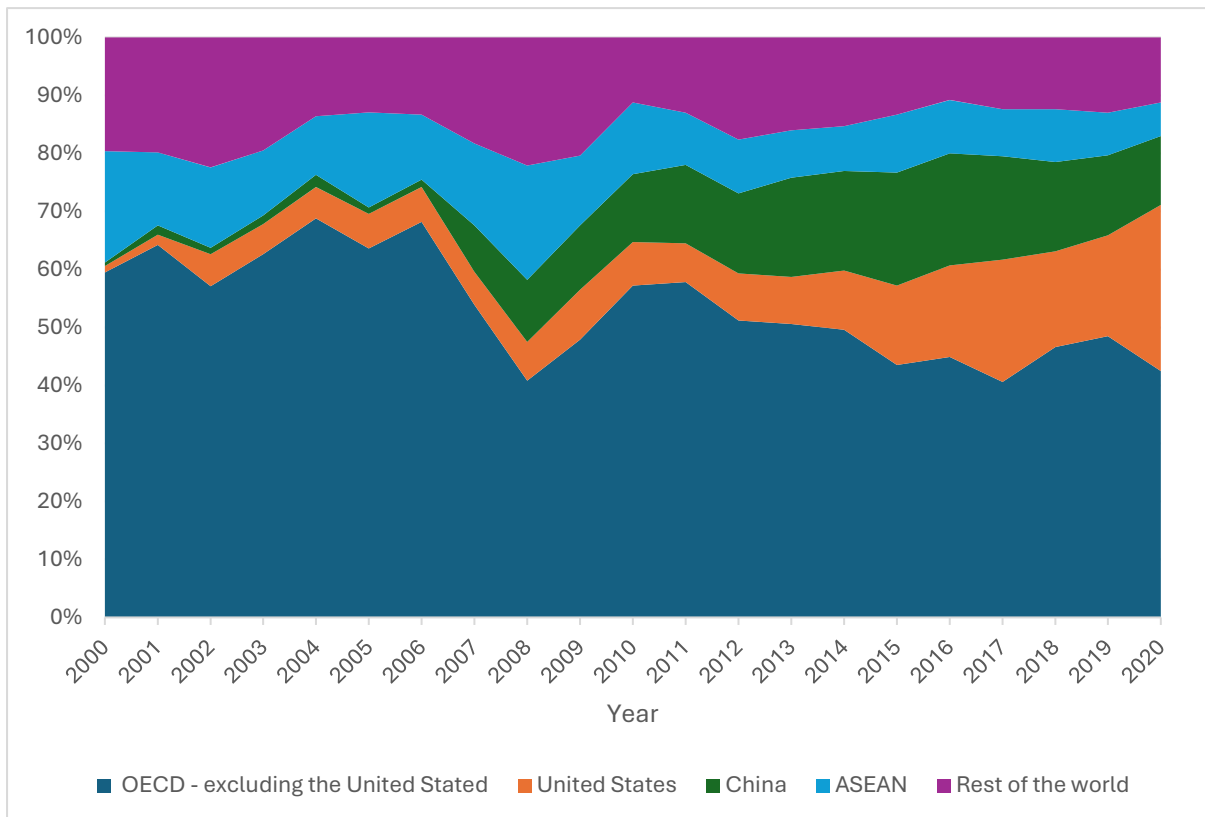
Figure 42: Vietnam’s domestic value-added in its gross exports of intermediate products in electrical equipment industry, destination partner shares (2000 – 2020)



Source: Author’s design using Trade in Value Added data - 2023 editions (OECD, 2023b)

Machinery intermediate products present a different scenario. OECD member countries (excluding the United States) have consistently been the largest recipients of Vietnam’s machinery intermediates, though their share fell from a peak of 68.8% in 2004 to 42.5% in 2020. The United States witnessed noteworthy growth, especially during the onset of the COVID-19 pandemic, jumping by over 10 percentage points to 28.6% in 2020. China’s share rose modestly, peaking at 19.5% in 2015 before declining to 11.9% in 2020. ASEAN countries displayed a fluctuating but overall downward trend, decreasing from 19.2% in 2000 to 5.8% in 2020. The rest of the world category varied over the years, peaking at 22.4% in 2002 and leveling off at 11.2% in 2020.

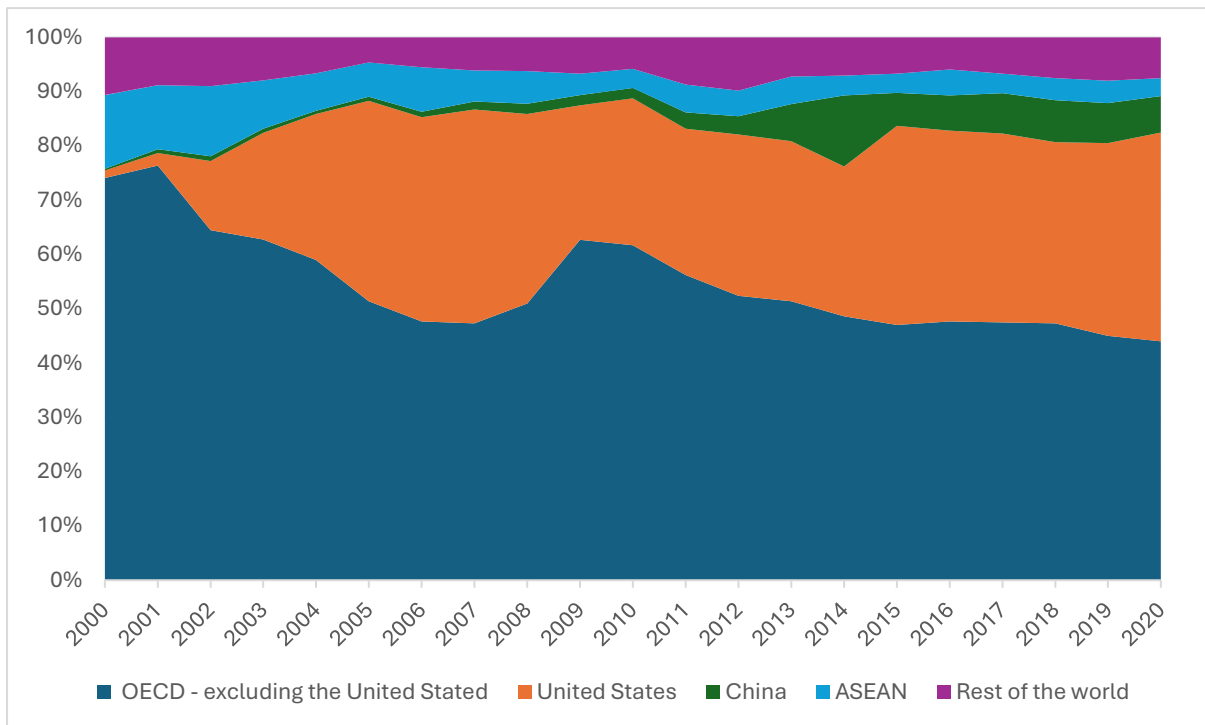
Figure 43: Vietnam’s domestic value-added in its gross exports of intermediate products in machinery industry, destination partner shares (2000 – 2020)



Source: Author’s design using Trade in Value Added data - 2023 editions (OECD, 2023b)

In the furniture industry, the United States is currently the top importer of Vietnam’s furniture intermediates, with a 38.5% share in 2020. Although the U.S. began with only 1.4%, it experienced its fastest growth between 2002 and 2009, reaching a high of 39.4% in 2007. During that period, declining shares from other OECD countries were more than offset by the rise in U.S. demand, resulting in OECD economies collectively accounting for 82.5% of Vietnam’s furniture intermediates. While China continued to expand its imports of Vietnam’s furniture intermediates, its share stood at a more modest 6.7% in 2020, still trailing the OECD share.

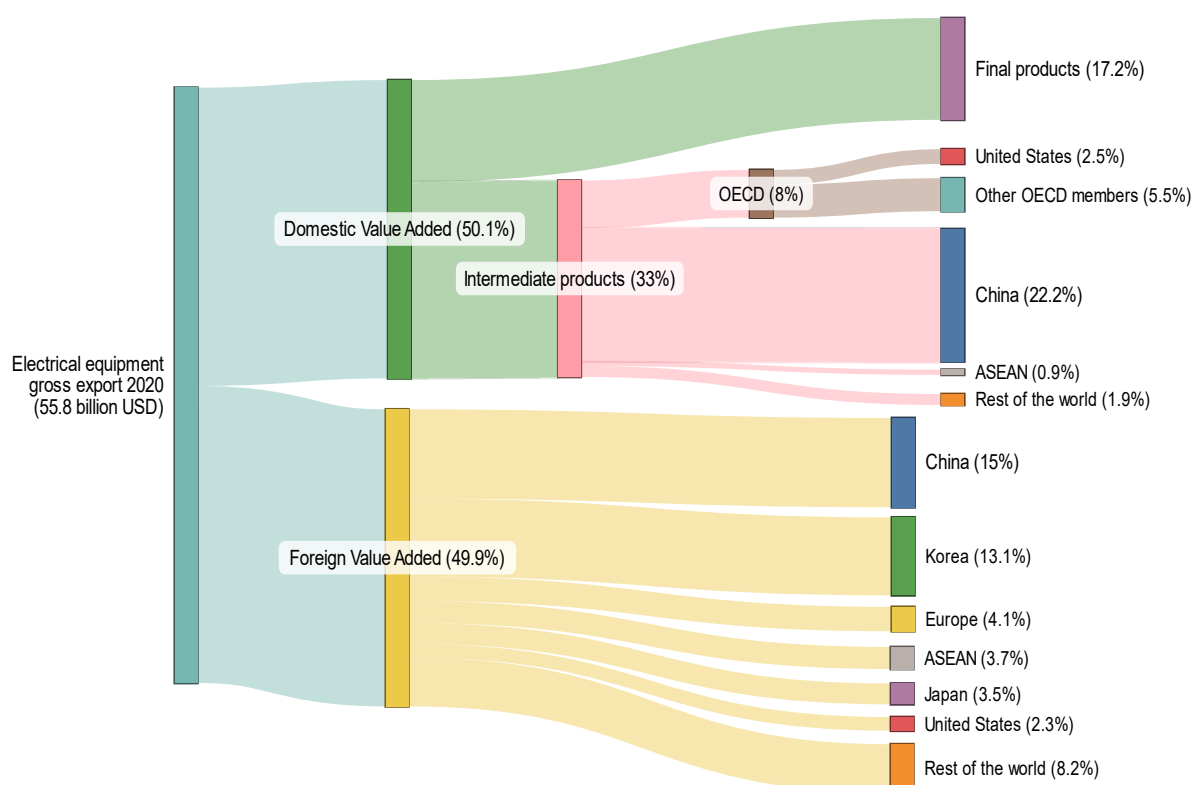
Figure 44: Vietnam’s domestic value-added in its gross exports of intermediate products in furniture industry, destination partner shares (2000 – 2020)



Source: Author’s design using Trade in Value Added data - 2023 editions (OECD, 2023b)

In concluding this chapter's findings, we consolidated various value-added indicators into Figure 45, focusing on the export of electrical equipment—an industry marked by rapid growth and strong FDI. The analysis underscores Vietnam’s dependence on imported inputs and its integration into global supply chains, with China holding a particularly prominent role. In 2020, exports of electrical equipment (including computer, electronic, and optical products) reached USD 55.8 billion. However, as noted earlier, only half of the value added in these exports was generated domestically (50.1%), while the remaining 49.9% was contributed by other countries through their design, processing, manufacturing, and material sourcing prior to import into Vietnam.

Figure 5: Vietnam’s electrical equipment export breakdown (2020)



Source: Author’s design using Trade in Value Added data - 2023 editions (OECD, 2023b)

On the input side, China emerged as the largest contributor to foreign value-added, accounting for 30% of the total foreign value (equivalent to 15% of total exports). Korea followed closely with 26% of the value, amounting to USD 7.51 billion. It's notable that Korea's value-added may mainly stem from activities higher up the value chain such as R&D, branding, and design, particularly in companies like Samsung and LG.

Scrutinizing the domestically added value, we observe that only 33.33% of this value (or 17.2% of the total export value) is exported in its final form. The remaining 66.67% of the value-added exports are in the form of intermediate products used for further processing along the supply chain. In this context, China again emerges as the largest destination for Vietnam's intermediate products. Its share of Vietnamese intermediate product exports dwarfs that of the rest of the world, capturing 67.39% (or 22.2% of the total export value).

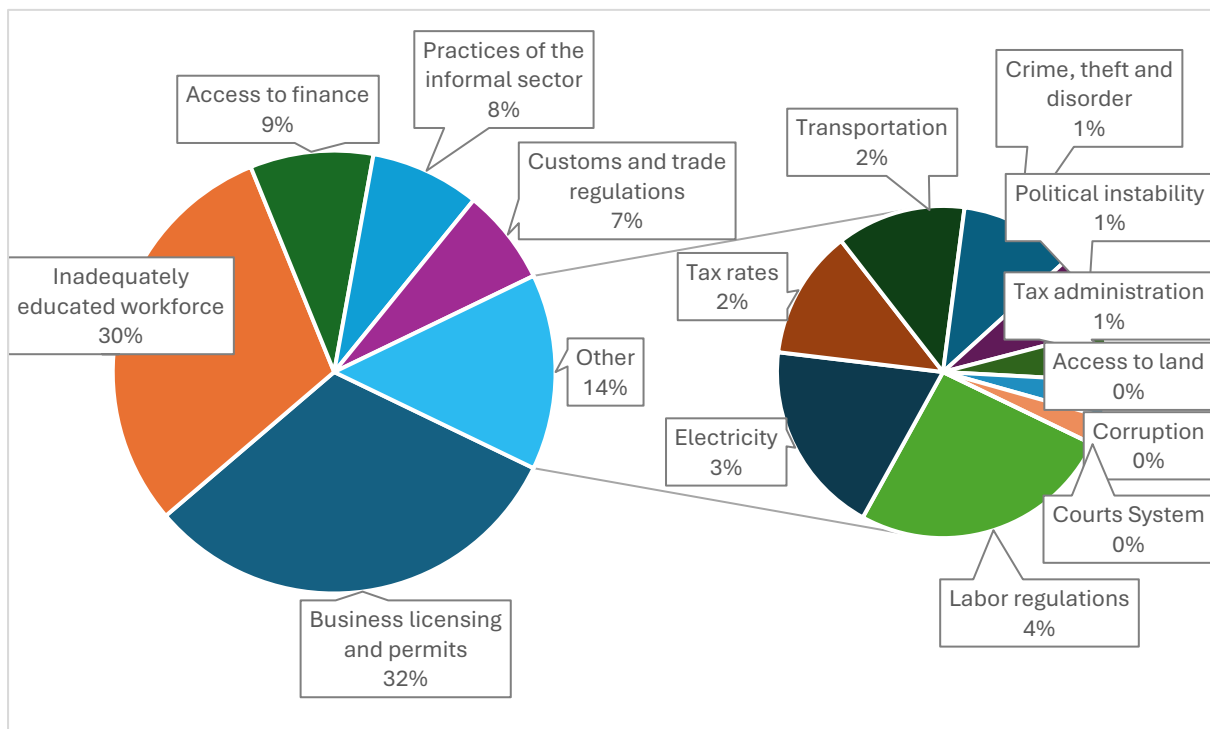
Viewed from both input and output angles, China’s dominant role in Vietnam’s supply chain remains evident—even in industries known for higher value-added, such as electrical equipment manufacturing. This pattern suggests that manufacturing growth in Vietnam may represent an “expansion,” rather than a wholesale “relocation” away from China. Nevertheless, certain sectors—like machinery and furniture—offer Vietnam the chance to reduce reliance on China and diversify its supply chain partnerships. For instance, furniture exports, though heavily oriented toward OECD markets, have maintained a

relatively steady share of domestic value-added, demonstrating Vietnam’s potential to develop its local manufacturing capabilities. By strategically focusing on these sectors and cultivating partnerships beyond China, Vietnam can mitigate risks associated with over-dependency on a single market.

V. From rising start to “World’s Factory”: Vietnam’s emerging challenges

While Vietnam possesses numerous advantages that make it an attractive destination for FDI, it faces significant challenges to achieve its goal of becoming the next "world’s factory." Using data from the World Bank Enterprise Surveys, over 32% of firms with at least 10% foreign ownership in the manufacturing sector reported “Business licensing and permits” as their biggest hurdles, closely followed by “Inadequately educated workforce” at 30%. Other challenges include "Access to finance" (9%), "Practices of the informal sector" (8%), and "Customs and trade regulations" (7%).

Figure 6: Vietnam’s biggest obstacle in doing business for foreign-owned enterprises (2023)



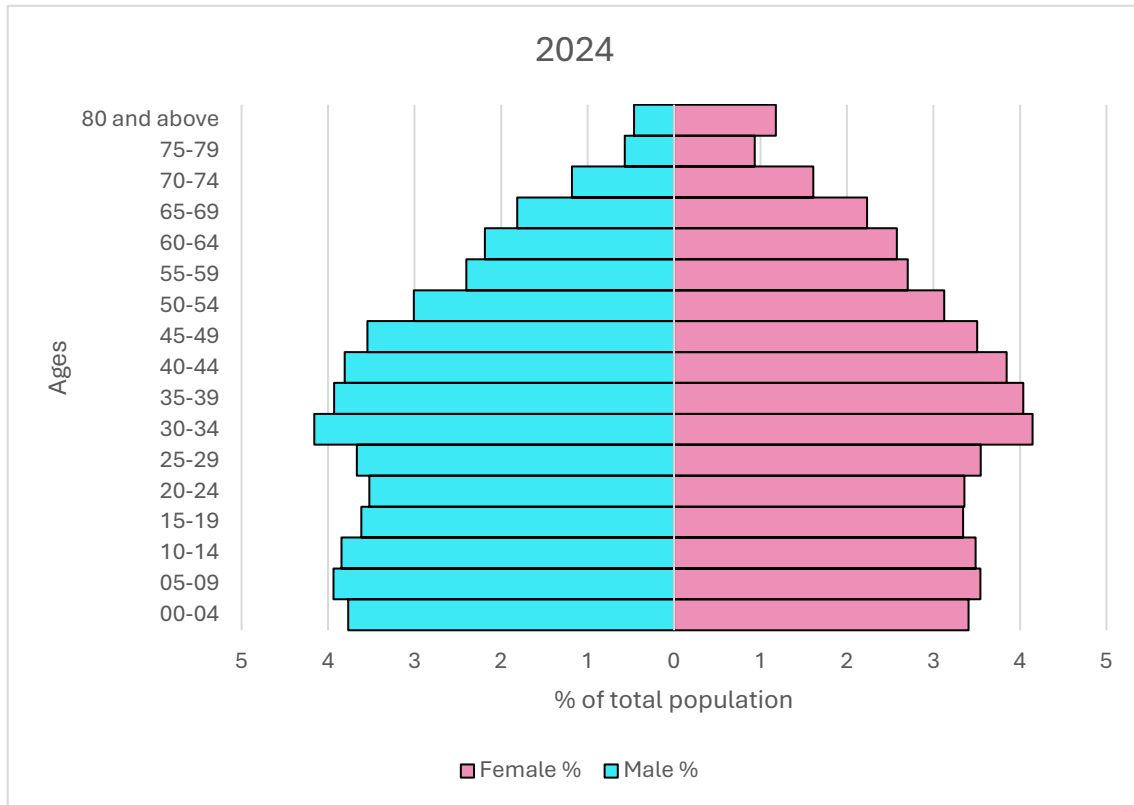
Source: Author’s design using World Bank Enterprise Surveys (World Bank, 2023a)

An aging population

Vietnam is experiencing a rapid rate of aging, one of the fastest globally. In 2024, individuals aged 65 and above constitute 10 percent of the total population. By 2050, this figure is projected to rise to over 20 percent. Currently, the most populous age group is 25-39, providing Vietnam with an abundant source of labor. In fact, the demographic window of opportunity in Vietnam started in 2007, a period when the working-age population (15-64) is twice the size of the dependent groups. However, the current data reveal signs of an aging

population, indicated by a shrinking base in the population pyramid due to the declining birth rate.

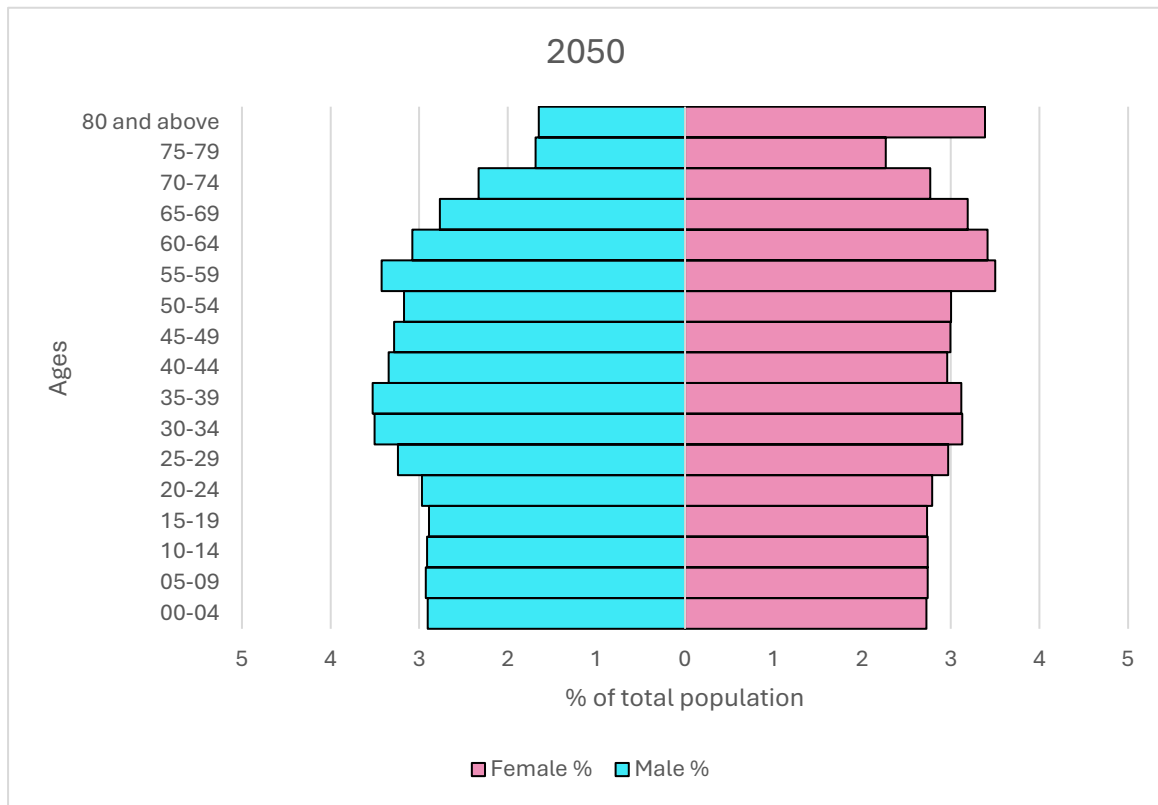
Figure 7: Vietnam population pyramid (2024)



Source: Author’s design using World Development Indicators data (World Bank, 2023b)

By 2036, Vietnam is predicted to become an aged society, marking a transition from its current aging demographic status. The period of the demographic window of opportunity is also expected to close by 2039 (General Statistics Office & UNFPA Vietnam, 2021). With only 15 years remaining in the opportunity window, the ambition of transforming Vietnam into the next “world’s factory” is increasingly uncertain. This situation suggests that the Vietnamese government needs to do more than just rely on a cheap and abundant labor force. Instead, it should develop strategies to improve the quality of its workforce in order to achieve its goal.

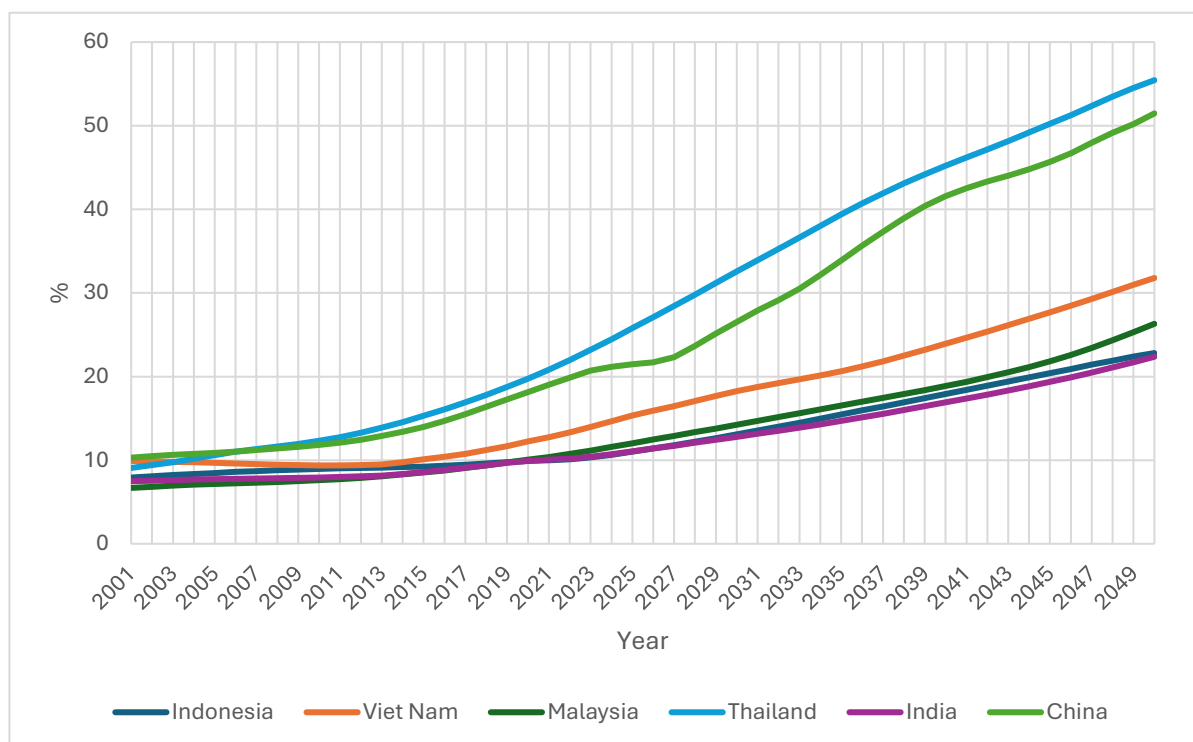
Figure 8: Vietnam population pyramid (2050)



Source: Author’s design using World Development Indicators data (World Bank, 2023b)

Enhancing workforce quality is particularly important for Vietnam when compared to other countries. Despite projections that Vietnam will have a lower old age (65 or more) dependency ratio than China and Thailand in 2050, its ratio remains high. Indonesia and India, both competitors of Vietnam for FDI, with lower projected dependency ratios and larger populations, may outpace Vietnam in attracting FDI if Vietnam continues to rely solely on labor quantity. Furthermore, a high old-age dependency ratio implies not only a reduced workforce but also increased demands for social security and healthcare, which places a further burden on the economically active population.

Figure 9: Old age dependency ratio of the total population - Trends and Projections (2001 – 2050)



Source: Author's design using World Development Indicators data (World Bank, 2023b)

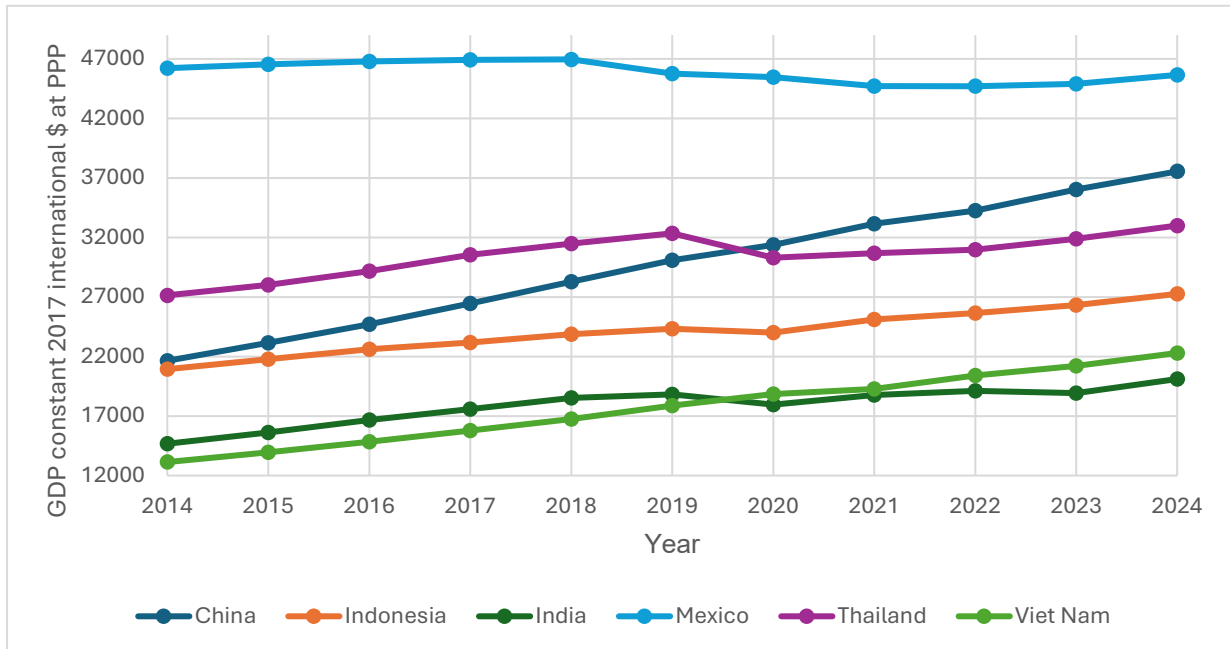
Quality of the Labor Force

The prospect of a shrinking labor force underscores the need for the government to prioritize investments in skill development. Currently, labor quality remains one of Vietnam's significant shortcomings. Data from the World Bank Enterprise Survey indicates that 20% of foreign-owned firms identify an inadequately educated workforce as a major constraint, and 30% consider it the biggest obstacle to conducting business in Vietnam. Vietnamese workers' productivity is notably low, with an average output of approximately \$22,295 (GDP constant 2017 at PPP) in 2022, ranking above only India and below Indonesia, China, and Thailand. This productivity gap is not due to a lack of effort but rather a lower baseline in skills and education compared to other nations. However, there is an encouraging upward trend in the productivity of Vietnamese workers, signaling potential for improvement.

The challenge for Vietnam, however, is that its competitors for FDI are also improving their workforce quality, often at a faster rate. For instance, between 2014 and 2024, Vietnam increased its output per hour worked from \$6.26 to \$10.27 (Figure 51). During the same period, China nearly doubled its output per hour from \$8.93 to \$16.06, widening the productivity gap from \$2 to \$6. To close this gap and compete effectively in

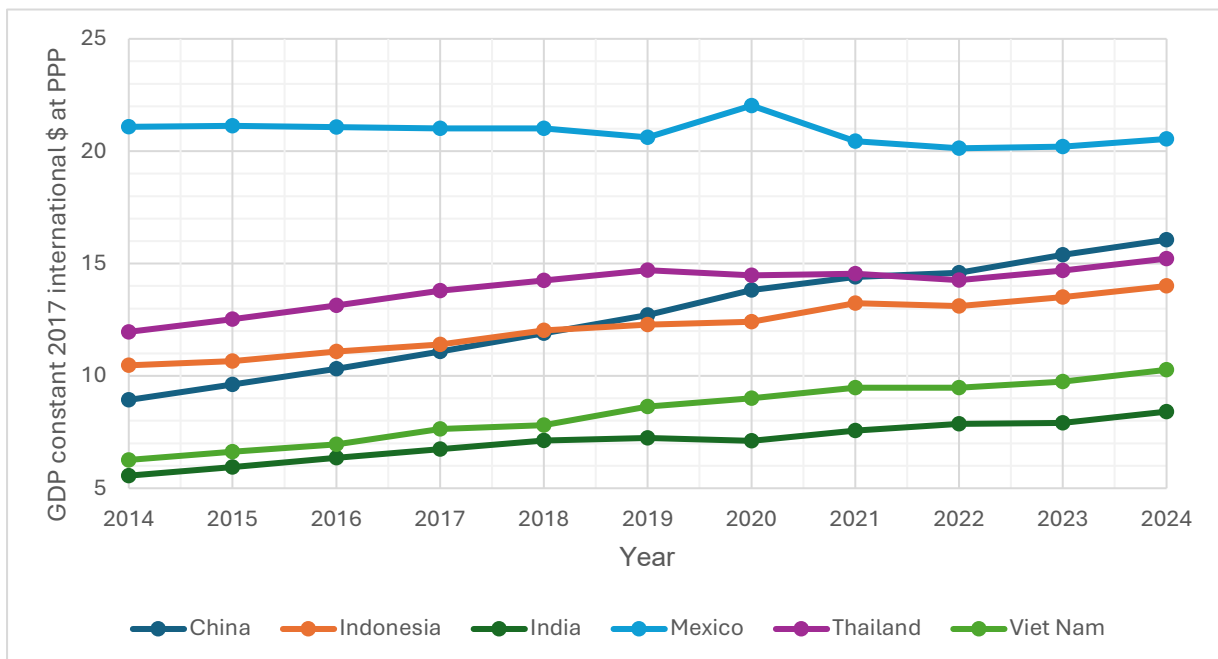
terms of productivity, Vietnam needs to achieve a growth rate in productivity that matches or exceeds that of China.

Figure 10: Output per worker (GDP constant 2017 international \$ at PPP) (2014 – 2024)



Source: Author's design using the International Labor Organization data

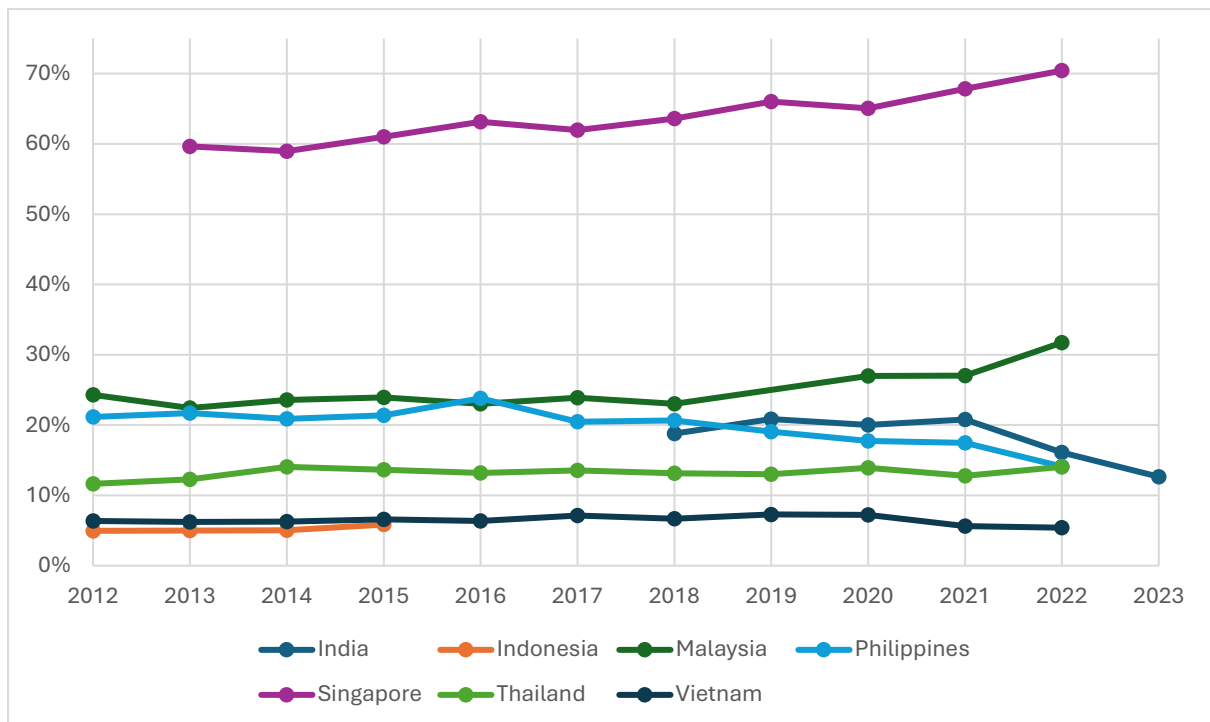
Figure 11: Output per hour worked (GDP constant 2017 international \$ at PPP) (2014 – 2024)



Source: Author's design using the International Labor Organization data

One of the key factors contributing to low productivity in Vietnam is the low ratio of high-skilled workers in the workforce. Indeed, Vietnam records the lowest percentage of high-skilled workers in the manufacturing sector among other ASEAN countries (excluding Indonesia, which only has data available up to 2015) (Figure 52). Additionally, the share of high-skilled workers in the manufacturing sector in Vietnam has declined from 6.3% in 2012 to 5.3% in 2023.

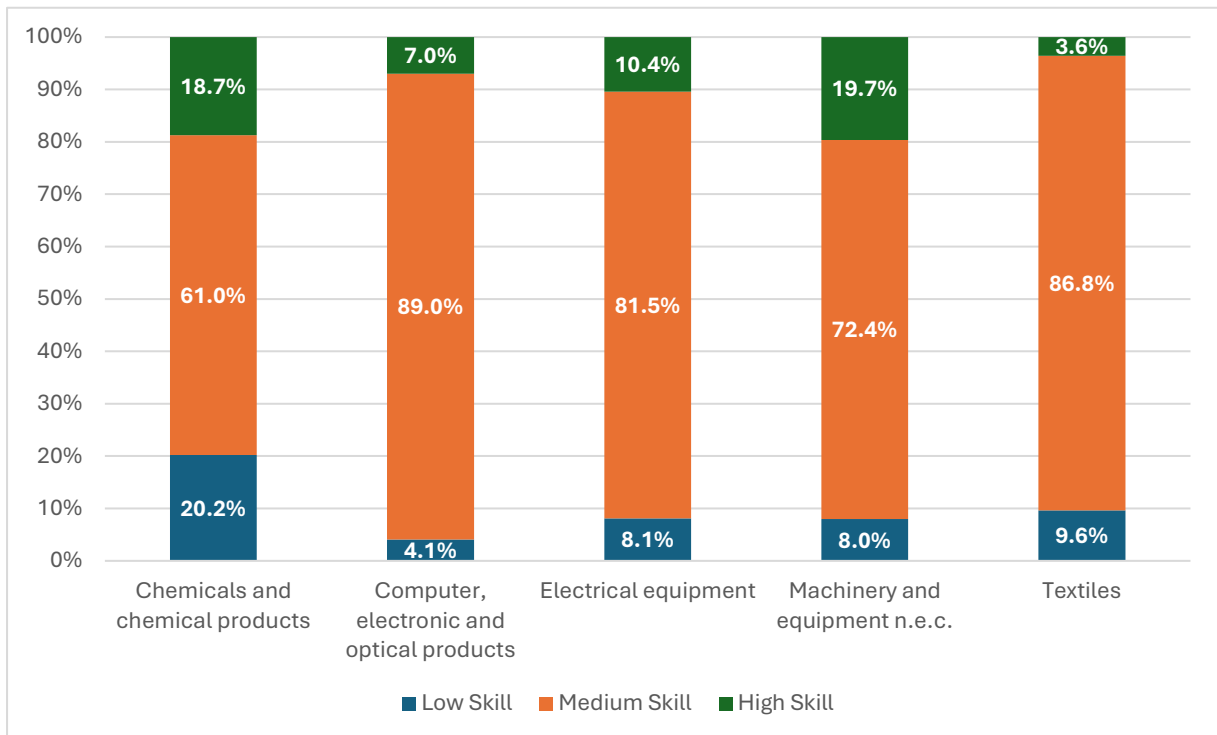
Figure 12: High skill-worker ratio in the manufacturing sector (2012 – 2023)



Source: Author’s design using the International Labor Organization data (International Labour Organization, 2024)

Further examination of the data reveals significant variation across different industries within the manufacturing sector. Industries with the highest ratios of skilled workers are Chemicals and Chemical Products and Machinery and Equipment, with 18.7% and 19.7%, respectively (Figure 53). Surprisingly, two of the fastest-growing manufacturing industries, Computers and Electrical Equipment, have considerably lower ratios of skilled workers, with the computer, electronic, and optical industry having only 7% of its workforce classified as high-skilled.

Figure 13: Vietnam’s Labor structure by worker’s skill in the manufacturing sector (2022)

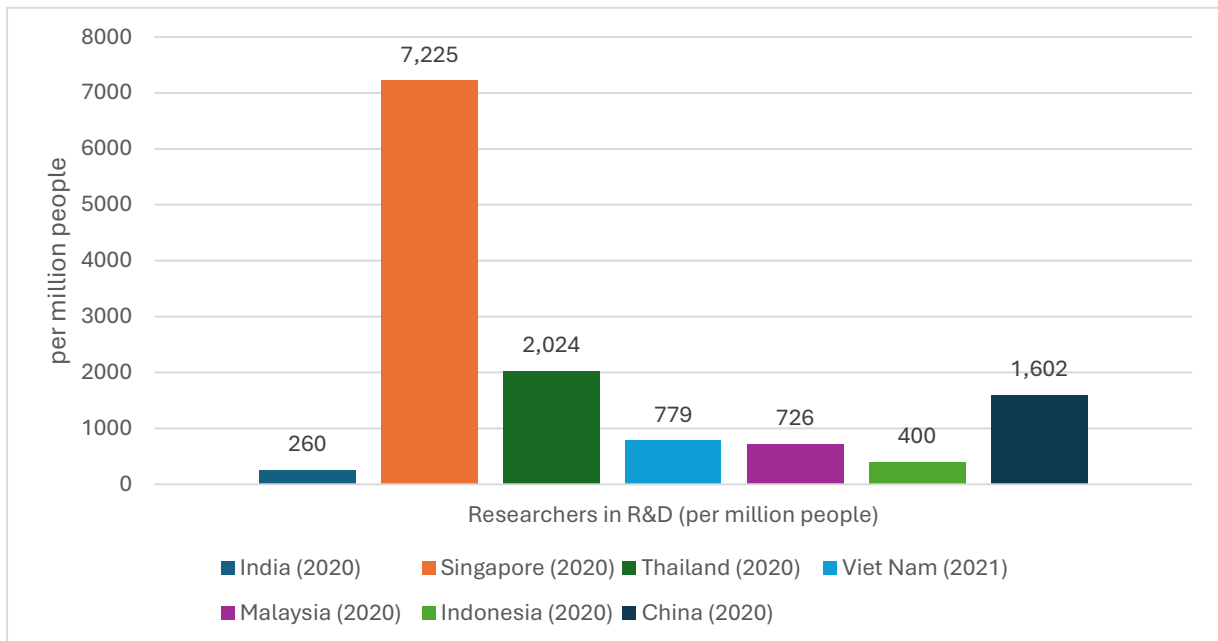


Source: Author’s design using the International Labor Organization data (International Labour Organization, 2024)

Innovation hurdles

The lack of an adequately educated workforce is also reflected in the sparse research workforce, especially in high-tech industries, thus challenging Vietnam’s effort to foster innovation and technology. In 2021, Vietnam reported about 780 researchers per million people, significantly lower than China with 1,602 researchers, Thailand with 2,024 researchers, and Singapore with 7,225 researchers per million people. This shortage is partly due to Vietnam, along with countries like Indonesia, and India being stuck at the lower end of the smile curve, where the focus is low-level manufacturing jobs. This focus limits opportunities for advancing into more sophisticated sectors that require high levels of research and development.

Figure 14: Researchers in R&D

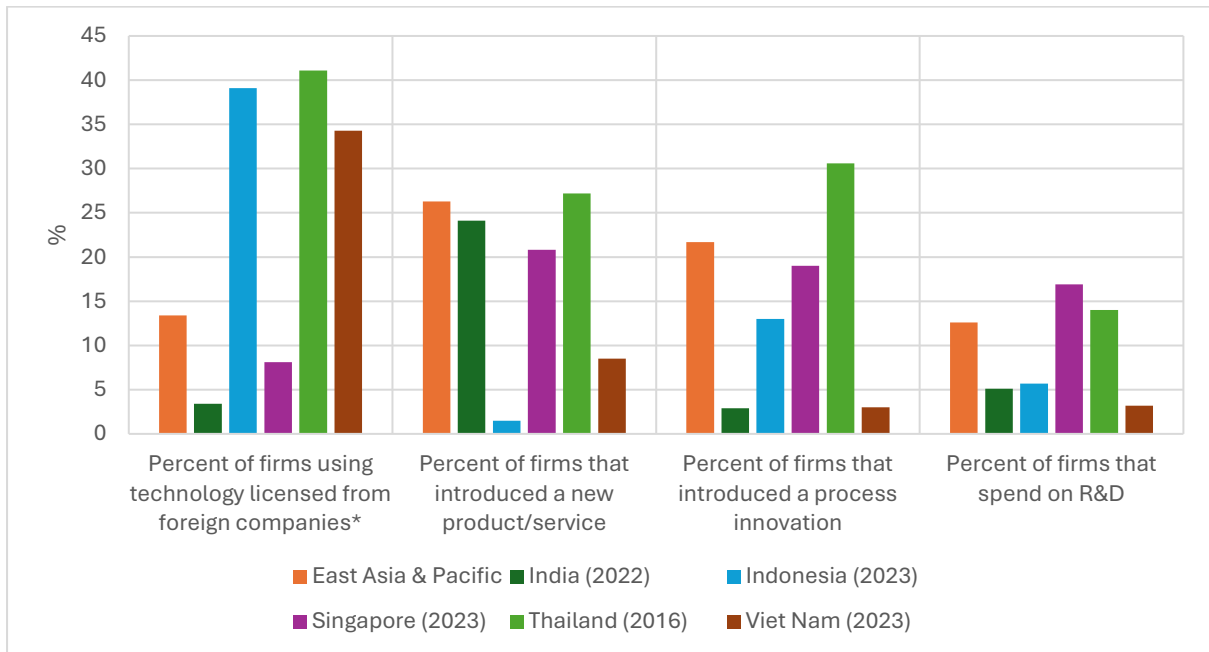


Source: Author's design using World Development Indicators data (World Bank, 2023b)

Additionally, Vietnam relies substantially on foreign technology, with 34.3 percent of foreign-owned firms in the country using technology licensed from abroad (Figure 55). This trend is reinforced by Vietnam's strong dependency on the Chinese supply chain for manufacturing inputs (as discussed in the previous section), as foreign firms often opt to integrate technologies from their home countries to expand their supply chains. Furthermore, only 3 percent of foreign-owned firms in Vietnam introduced a process innovation to their usual business practices. This lack of innovation contributes to the low productivity among Vietnamese workers. The reliance on traditional manufacturing processes, while potentially reducing training costs for new workers, in the long run, hinders Vietnam's competitiveness as a destination for FDI. Vietnamese workers, unable to keep up with technological advancements, would fall behind their counterparts in other countries.

Investment in R&D is also lacking, with only 3.2 percent of foreign-owned firms investing in R&D, far below the East Asia and Pacific regional average of 12.6 percent (Figure 55). This underinvestment in R&D perpetuates reliance on foreign technology, creating a vicious cycle that stifles domestic innovation and technological advancement.

Figure 15: Innovation Indicators ⁷



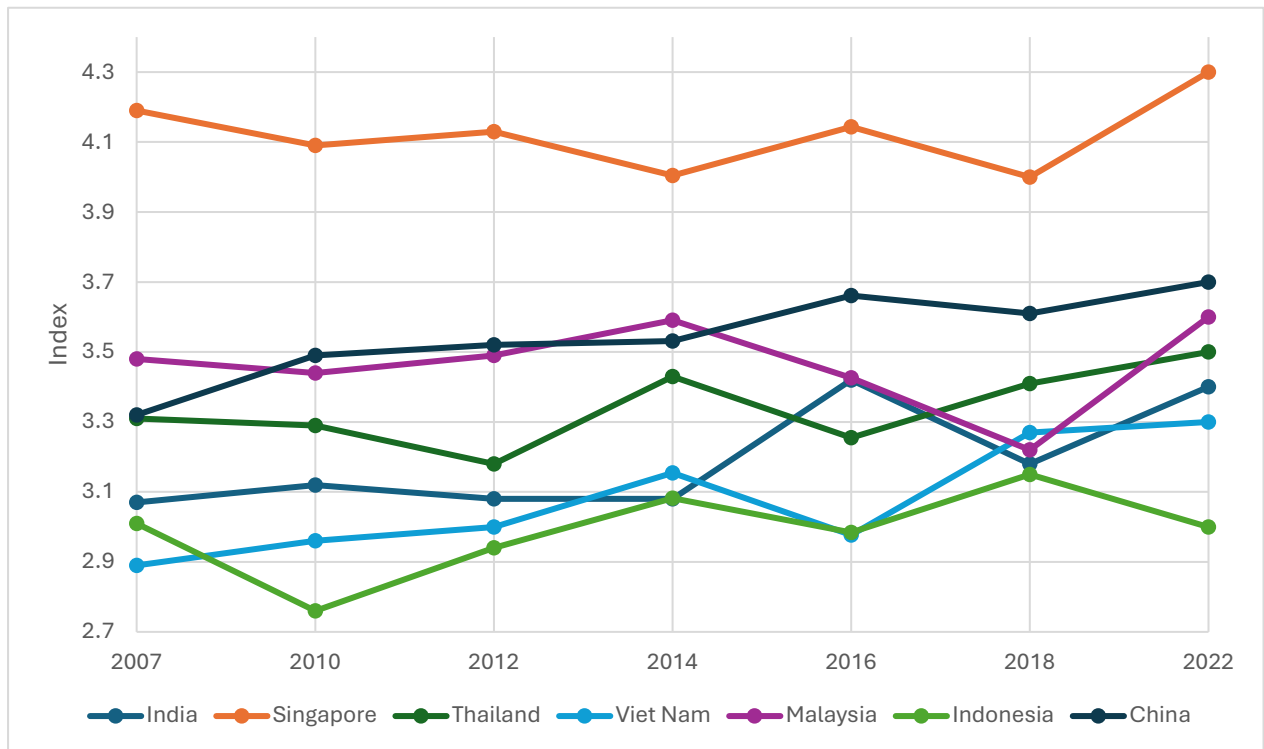
Source: Author's design using World Bank Enterprise Surveys (World Bank, 2023a)

Logistics barriers

Vietnam, strategically located next to China, serves as a critical gateway connecting China with the rest of ASEAN countries through the South China Sea. Despite its advantageous position and the presence of deep-water ports facilitating efficient goods transportation, Vietnam's Logistics Performance Index (LPI) remains relatively low. In 2022, Vietnam's LPI score was 3.3, ranking above Indonesia but behind other regional competitors like India, China, Thailand, Malaysia, and Singapore (Figure 56). With China advancing its Belt and Road Initiative (BRI) and more ASEAN countries participating, there is a risk that Vietnam's logistics capabilities could be further outpaced. If new infrastructure developments enable smooth transit routes between China and Southeast Asia that bypass Vietnam, the country could lose its critical role as the regional bridge.

⁷ The * means that the indicator is computed using data from manufacturing firms only.

Figure 16: Logistics Performance Index (2007 – 2022)



Source: Author's design using World Development Indicators data (World Bank, 2023b)

However, when we broke down Vietnam's 2022 LPI score into various components, certain strengths emerged. Vietnam excels in the ability to track and trace consignments, scoring around 3.4. Additionally, Vietnam performs well in terms of the frequency with which shipments reach consignees within the scheduled or expected time. These strengths are crucial for attracting FDI as they ensure reliability and predictability in supply chains. The primary weakness in Vietnam's logistics performance is the efficiency of its customs clearance process, an issue tied to government effectiveness that will be discussed further below. Additionally, the quality of trade and transport-related infrastructure, which is the second lowest index, poses a significant challenge.

Figure 17: Vietnam's Logistics Performance Index Breakdown (2022)

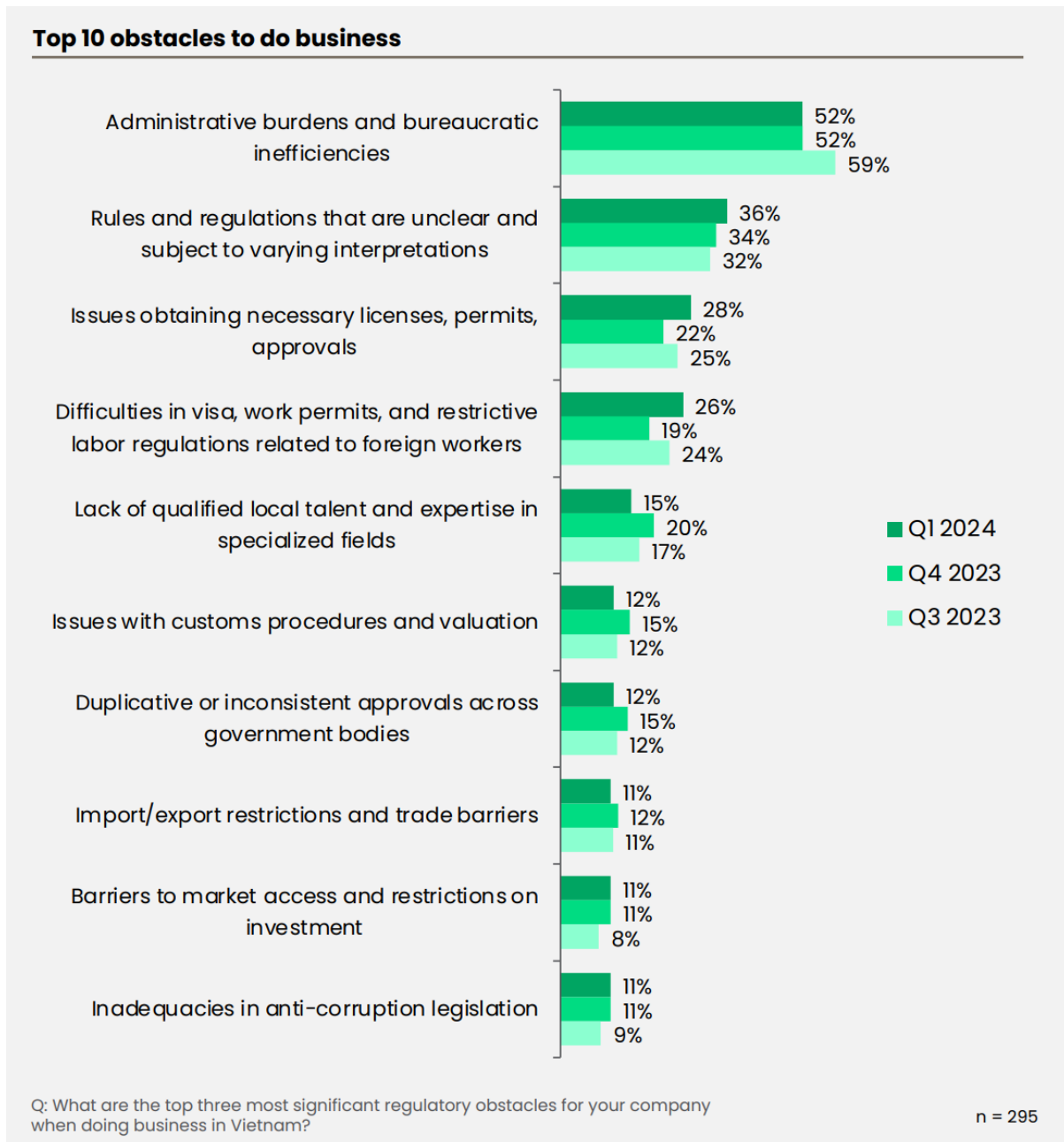


Source: Author's design using World Development Indicators data (World Bank, 2023b)

Bureaucratic hurdles

As mentioned at the start of this section, administrative burdens, particularly in obtaining permits and licenses, are considered the biggest obstacles for foreign-owned businesses operating in Vietnam. According to a report by the European Chamber of Commerce in Vietnam (EuroCham) (EuroCham, 2024), the top four obstacles to doing business in Vietnam are all related to government effectiveness and regulatory measures. More than 52% of the surveyed firms considered administrative burdens and bureaucratic inefficiencies as significant barriers. Similarly, the American Chamber of Commerce in Vietnam emphasized the issues faced by FDI firms in Vietnam, including the slow approval process for FDI projects and time-consuming administrative procedures, which hinder business progress and undermine Vietnam's competitiveness (Minh, 2023). Furthermore, the ongoing efforts to refine these processes and procedures are frequently plagued by overlapping responsibilities and authorities among governmental agencies, leading to a lack of transparency and consistency in government policies and decisions, which adds to the complexities facing foreign investors.

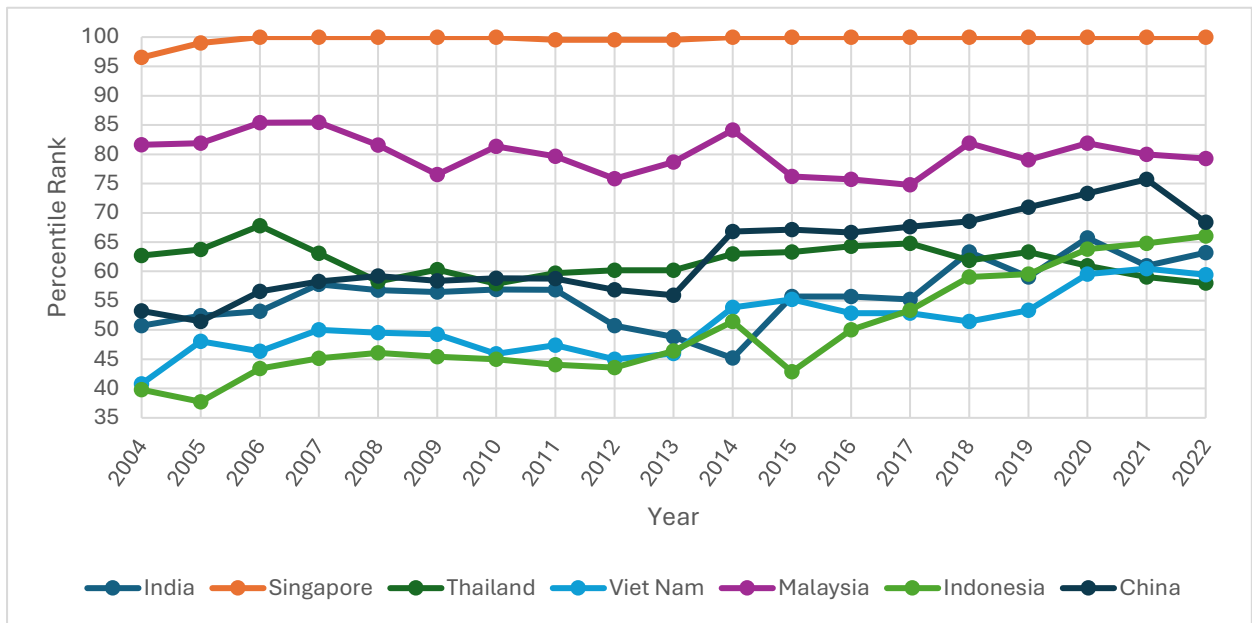
Figure 18: Vietnam's Top 10 obstacles to do business (2022)



Source: Eurocham Business Confidence Index – Quarter 1, 2024 (EuroCham, 2024)

Analyzing the World Bank's government effectiveness indicator, it is evident that Vietnam has made significant efforts to enhance its governance, climbing from the 40th percentile in 2004 to the 60th percentile in 2022. Despite this progress, Vietnam still lags behind most regional counterparts, just slightly ahead of Thailand, which has faced political instability, including a coup in 2014. Notably, Indonesia, which began at a similar level to Vietnam, surpassed it in 2017 and has sustained improvements since then. This comparison highlights that, while Vietnam has advanced, there is still a significant need for further enhancements in governance to keep pace with regional peers.

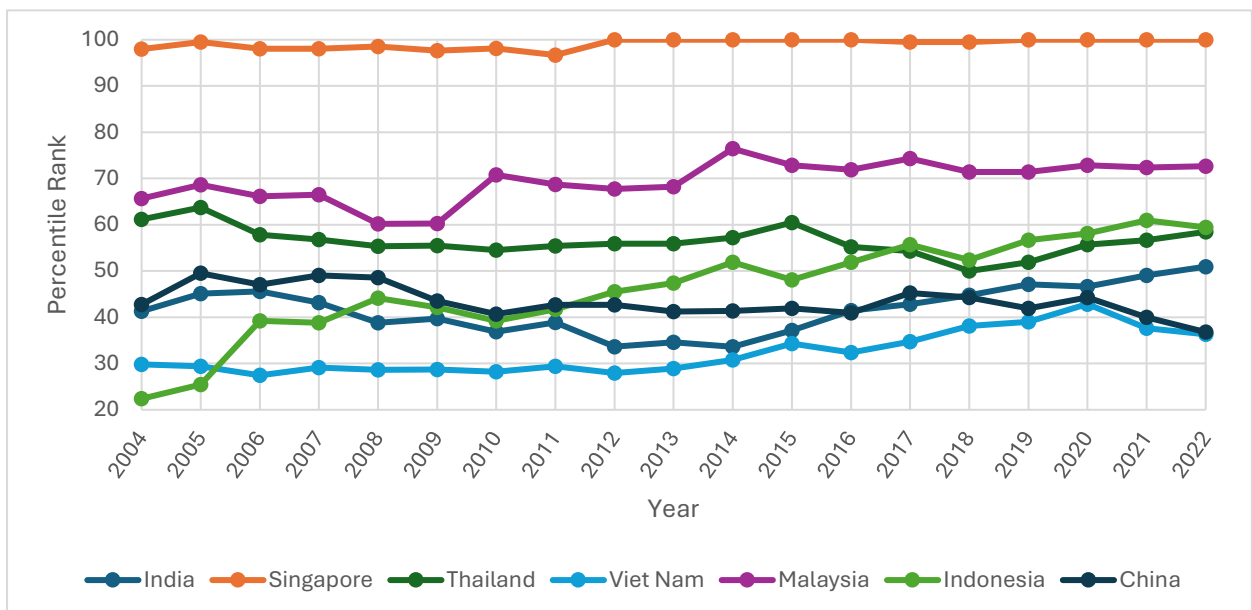
Figure 19: Government Effectiveness: Percentile Rank (2004 - 2022)



Source: Author's design using World Development Indicators data (World Bank, 2023b)

Vietnam also performs poorly in regulatory quality indicators. Although there has been some improvement, Vietnam still ranks last in this category at the 36th percentile rank, marking a modest six-point improvement since 2004. In contrast, Indonesia, one of Vietnam's main competitors for FDI, has seen significant regulatory reforms since 2006. These reforms have not only allowed Indonesia to surpass Vietnam but have also significantly widened the gap in terms of regulatory quality between the two countries.

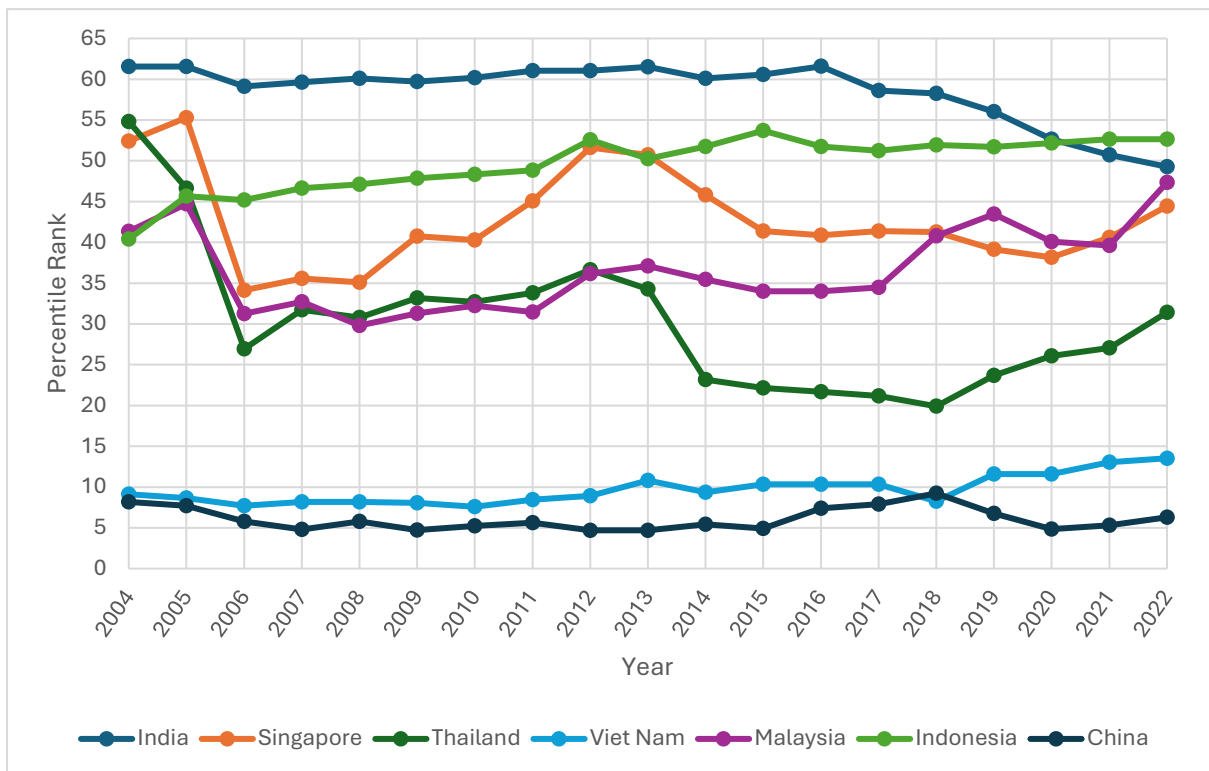
Figure 20: Regulatory Quality: Percentile Rank (2004 - 2022)



Source: Author's design using World Development Indicators data (World Bank, 2023b)

Over the years 2004 to 2022, Vietnam's rankings in the indicators for voice and government accountability have remained relatively stable. Although there was a slight improvement, moving from the 10th percentile in 2004 to the 15th percentile in 2022—positioning it just above China—the country continues to rank below regional peers like Singapore, Malaysia, and Thailand. This consistently low ranking reflects significant constraints in political freedoms and government accountability. Addressing these limitations is crucial for enhancing public trust and creating a more transparent business environment in order to attract investment.

Figure 21: Voice and Accountability: Percentile Rank (2004 - 2022)

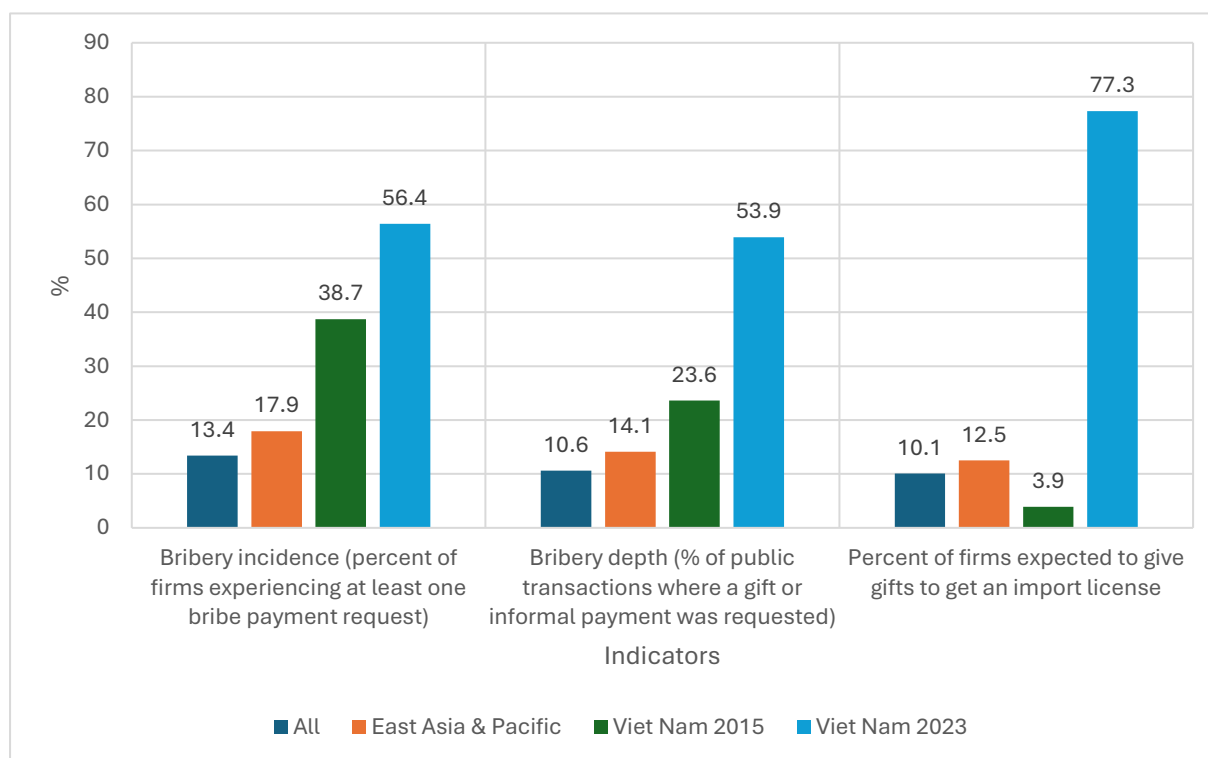


Source: Author's design using World Development Indicators data (World Bank, 2023b)

An interesting observation from business operations in Vietnam is that even though business firms experience significantly more corruption in Vietnam compared to other countries, the majority of the firms don't consider corruption as a barrier to their business. For example, 56.4% of foreign-owned firms in Vietnam reported experiencing at least one request for a briber payment, significantly higher than East Asia & Pacific's average of 17.9% and an increase compared to 2015. Most alarmingly, 77.3 percent of these firms reported they were expected to give gifts to secure an import license, which is 6 times higher than the region's average of 12.5%.^{8 9}

⁸ For *Bribery incidence* and *Bribery depth* indicators, the sample size for firms with 10% or more foreign ownership in 2015 and 2023 are 47 and 51 respectively. The *Percent of firms expected to give gifts to get an import license* sample size in 2015 and 2023 are 14 and 20 respectively.

Figure 22: Corruption Indicators



Source: Author's design using World Bank Enterprise Surveys (World Bank, 2023a)

However, despite the high levels of corruption reported by the surveyed firms, only 8.6 percent of the foreign-owned firms in Vietnam identified corruption as a major constraint, smaller than the East Asia & Pacific average of 21.1 percent and the world average of 25.4 percent, respectively. Moreover, none of the firms surveyed regard corruption as the biggest obstacle to their operations. This conundrum might be explained by the possibility that, although corruption is pervasive, the monetary amounts involved might not be substantial, or it could indicate that foreign firms have become accustomed to the corruption in Vietnam, and consider “greasing the wheel” part of their business expenses.

The unintended consequences of the antigraft campaign

Even though corruption isn't seen as the greatest barrier by foreign enterprises in Vietnam, the incidence of corruption remains notably high compared to other countries in the region. Recognizing corruption as a substantial threat not just to attracting FDI but also to the stability of the system, the Vietnamese government initiated an aggressive anti-corruption drive. This campaign, known as the "Blazing Furnace" (“Đốt lò” in Vietnamese) was led by the former General Secretary Nguyen Phu Trong beginning in 2013, aimed at cleansing corruption within the party and government to restore public trust.

⁹ The World Bank Enterprise Survey captures the sentiments and experiences of firms, but these results do not necessarily indicate an actual increase in corruption.

Nguyen Phu Trong initially took a measured approach to the campaign, emphasizing the need for resoluteness balanced with caution. He advocated for a strategy that would ensure long-term stability and avoid creating mistrust, suspicion, or disorder. However, the campaign's intensity has escalated over the years. Between 2012 and 2022, more than 167,700 members of the Communist Party of Vietnam were disciplined, with 7,390 cases directly related to corruption. The government also conducted court trials of 2,439 corruption cases with 5,647 defendants, of which 37 defendants were former central officials. Civil judgment enforcement agencies at all levels recovered VND 61,000 billion (Minh Ngoc, 2022).

Vietnam's ongoing campaign has produced demonstrable results, including significant improvement in the country's ranking under the Transparency International Corruption Perception Index ("CPI") in recent years. Vietnam — which ranked 113th in the world with a score of 33 in 2016 — has now improved to rank 83rd with a score of 41 in the latest CPI from 2023 (Transparency International, 2024).

Figure 23: Vietnam’s CPI score (2023)

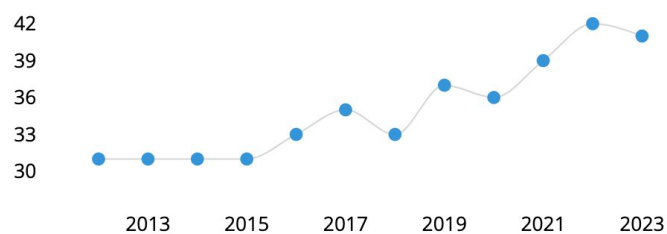
ASIA PACIFIC

VIETNAM

Score [What does the CPI score mean?](#)
41/100

Rank **Score change**
83/180  **-1** since 2022

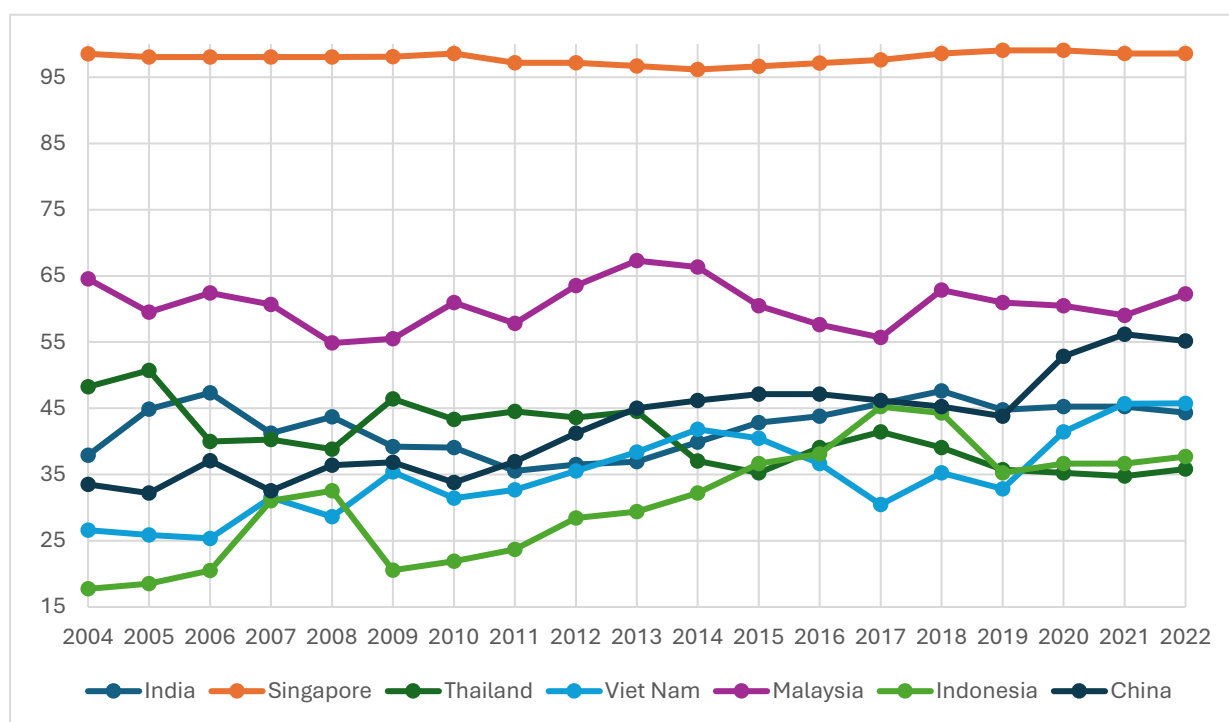
Score changes 2012 - 2023



Source: 2023 Corruption Perceptions Index (Transparency International, 2024)

Vietnam's efforts to combat corruption are further demonstrated by Vietnam's improved ranking in the World Bank's control of corruption indicator. Over recent years, Vietnam has seen its percentile rank increase from around 25 percentile to 45 percentile. While it is still ranked below China, Malaysia, and Singapore, this progress proves a significant commitment by Vietnam's government to address corruption issues.

Figure 24: Control of Corruption: Percentile Rank (2004 - 2022)

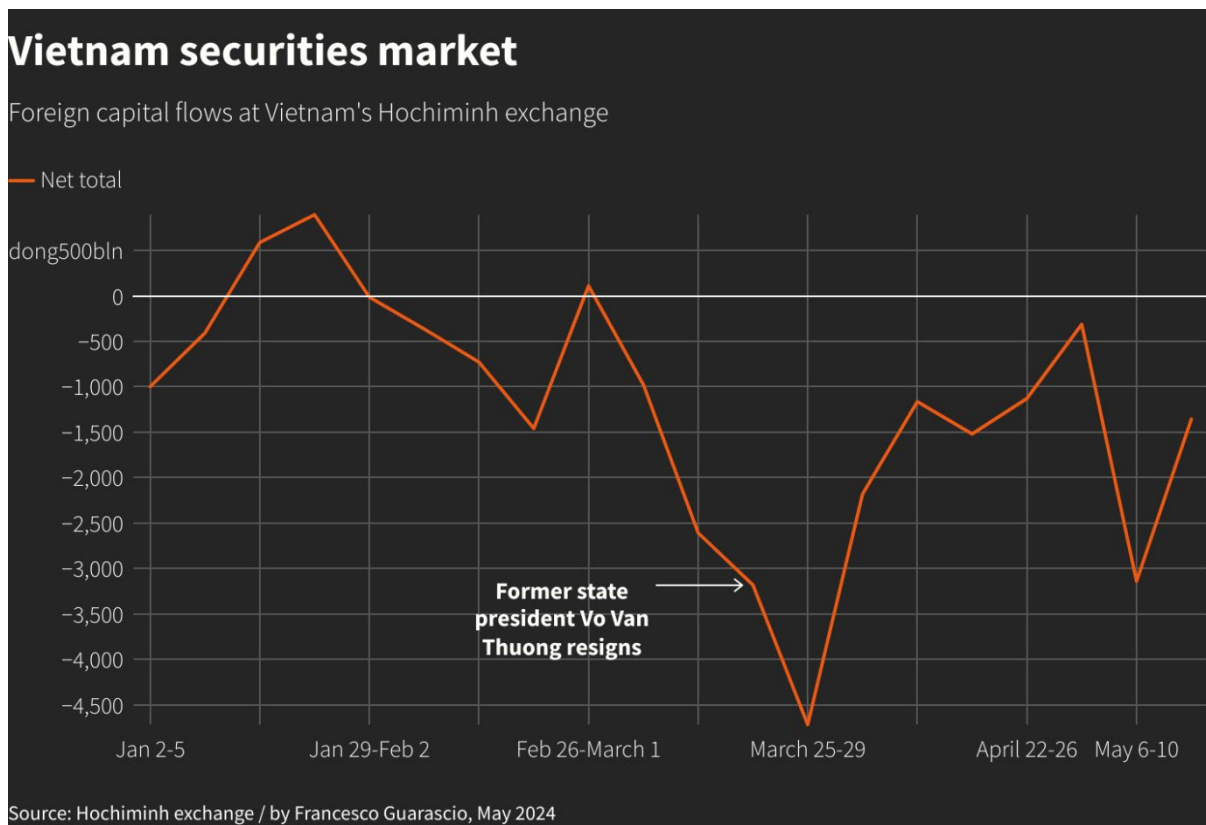


Source: Author's design using World Development Indicators data (World Bank, 2023b)

Despite notable strides in combating corruption, Vietnam's political arena has experienced significant turmoil, marked by the removal of five high-ranking officials over a year from 2023, including two deputy prime ministers, two presidents, and one chairperson. This unprecedented series of resignations has introduced a level of political instability that is unusual in Vietnam's history, stirring concerns and uncertainties among investors. Analyzing data from the Ho Chi Minh Stock Exchange, Guarascio and Nguyen (2024) argue that the unprecedented political turbulence in the past 2 years has caused a massive exodus of foreign security holdings. Although the market saw a 22% increase since the beginning of 2023, reaching a valuation of USD 200 billion, foreign investors have reduced their stakes, selling approximately USD 2 billion in stocks, funds, and bonds over the same period. Notably, half of these divestments occurred in 2024, with the timing of outflows aligning closely with periods of adverse political news.

Westervelt (2023) agrees with the analysis, suggesting that the anti-corruption campaign, while crucial for governance, has inadvertently placed a severe strain on the economy. He posits that the campaign could act as an economic brake, potentially slowing down Vietnam's economic growth and deterring future investment due to increased risk perceptions among international investors. This situation underscores the delicate balance required between enforcing anti-corruption measures and maintaining economic stability and investor confidence.

Figure 25: Foreign capital flows at Vietnam's Ho Chi Minh exchange



Source: Reuters Graphics (Guarascio and Nguyen, 2024)

On the flip side, some researchers maintain a positive outlook on Vietnam's ability to remain an appealing destination for FDI, despite the recent political upheaval. Tran et al. (2023) suggest that Vietnam still demonstrates healthy growth prospects and offers considerable opportunities for private equity funds and foreign investors across various sectors. This optimism is echoed by Vietnamese Foreign Minister Bui Thanh Son, who downplayed the impact of the presidential resignation on the country's foreign and economic policies. Bui stated "The resignation of the president I think in Vietnam has not affect(ed) our foreign policy as well as our own policies of economic development" (Brunnstrom & Lewis, 2024). This perspective underscores a belief in Vietnam's resilience and its ability to sustain a stable and attractive investment environment, despite internal political challenges

The contrasting views on the effects of the current Vietnamese political landscape could be due to the fact that these events are relatively new, as they happened in a period of just more than one month (20 March 2024 – 26 April 2024). Given that FDI projects, especially in the manufacturing sector, tend to be planned and decided years in advance, the immediate effect on FDI inflows may not be readily apparent. In the short term, it is anticipated that the trend of increasing FDI to Vietnam will continue.

With the next National Congress scheduled for early 2026, some investors may adopt a "wait and see" strategy. This cautious approach might be influenced by the desire to understand how the political landscape will stabilize post-congress and what policies the new

leadership will prioritize. However, in May 2024, the National Congress of Vietnam has already successfully elected a new President and new Chairman of the National Assembly to fill the vacancies. The Vietnamese government's ability to effectively manage this leadership transition smoothly can reassure investors and minimize the potential negative impacts on FDI inflows, maintaining Vietnam's position as a favorable investment destination.

However, affecting investors' sentiment is not the only side effect of the ongoing anti-graft campaign. Even if the leadership remains stable, the ramping crackdown is causing fear among public officials, leading to governmental paralysis or policy paralysis. (Luong, 2024) highlights that this crackdown has led to a hesitancy among officials to make decisions due to the increasing fear of making missteps, which slows down essential processes like procurement contract approvals and public fund disbursements. This caution is considered a more significant deterrent to FDI inflows than leadership changes. Further compounding the issue, (Guarascio and Vu, 2024) claims that Vietnam has forfeited at least USD 2.5 billion in foreign aid over the last three years and may lose another USD 1 billion due to this administrative paralysis. This paralysis underscores the substantial impacts of the crackdown on the ease of doing business and the attractiveness of Vietnam as an FDI destination.

VI. Conclusion

In conclusion, while FDI remains a key driver of economic activity and employment in Vietnam, policymakers and businesses must advance beyond basic assembly to more sophisticated production that increases local value-added in exports. Without this shift, Vietnam risks missing its 2045 goal of achieving high-income status. Attracting additional FDI in higher value-added, tech-intensive industries is essential, yet the country also faces pressing challenges in infrastructure, labor force development, and governance. Meeting these challenges will require a comprehensive policy approach that strengthens government effectiveness and transparency, bolsters workforce skills, and upgrades infrastructure—critical steps to position Vietnam as the world's next manufacturing powerhouse.

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