Vietnam's Integration in Global Value Chains: Opportunities and Vulnerabilities

Lin Jones (lin.jones@usitc.gov), Office of Economics

Various studies identified Vietnam as one of the most attractive outsourcing destinations for foreign investors seeking to diversify or expand their supply chains business in East Asia and Pacific (EAP) region.[1] With its relatively low labor cost, proximity to major hubs in the region, openness to trade and investment, pro-business policies, and stable political environment, Vietnam not only has become a favorite outshourcing location for certain manufacturing industries, but also has been recognized as the next offshoring hotspot for IT and business processing services. This executive briefing on trade profiles Vietnam's participation in international trade and global value chains (GVCs), and discusses (1) its opportunities for deepening GVC integration and moving up value chains, (2) its vulnerabilities in relying on a handful countries for inputs and export markets, and (3) its constraints such as under-developed domestic supply chains.

Vietnam outperformed its peers in growing trade and investment

During 2010–20, Vietnam made notable progress in reducing trade and investment barriers. Partly due to this, Vietnam's merchandise trade flourished, growing at an average annual rate of 13 percent from $157 billion in 2010 to $543 billion in 2020. In 2020, Vietnam had a merchandise trade-to-GDP ratio of 2.01, significantly higher than its peers in the region (figure 1). Vietnam also outpaced its peers in attracting foreign direct investment (FDI), receiving nearly $71 billion FDI net inflows in 2020. It was one of the few economies that had increased FDI inflows under the COVID-19 pandemic (figure 2).

Figure 1 Merchandise trade as a share of GDP, 2010–20

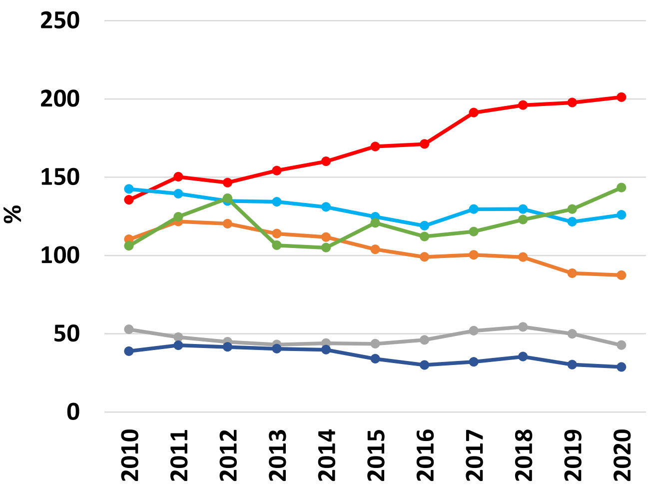
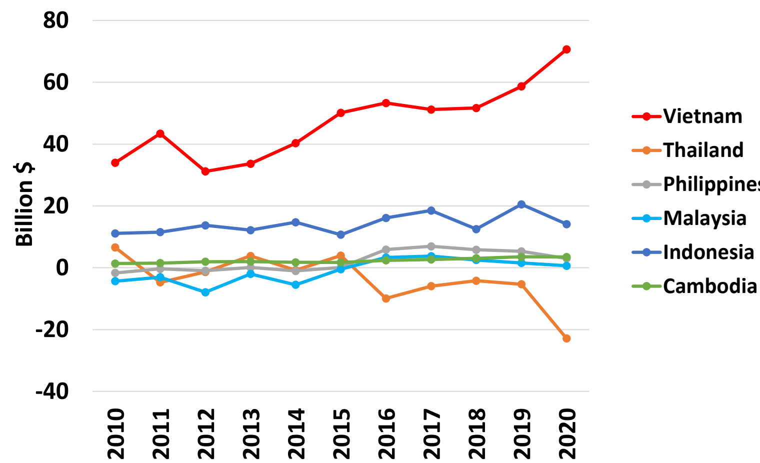


Figure 2 Net FDI inflows, 2010–20



Sources: WB, World Development Indicators, accessed September 2, 2021; UNCTAD, FDI flows, accessed September 1, 2021

Vietnam became more integrated into global value chains (GVCs) through backward participation

Corresponding to its rising trade and FDI inflows, Vietnam has become more integrated into GVCs, primarily through specializing in downstream production such as assembling imported inputs into final goods for exports. Its backward GVC participation index, measured by the share of foreign value content in gross exports, rose from 36.1 percent in 2005 to 44.5 percent in 2015, surpassing its peers in the region. In comparison, its forward GVC participation index, measured by the share of domestic value content in gross exports used in other countries' export production, declined from 14.5 percent in 2005 to 11.1 percent in 2015, below its peers in the region. These measures reflect Vietnam's limited development in upstream production such as producing raw materials or intermediate inputs for its own or other countries' export production.

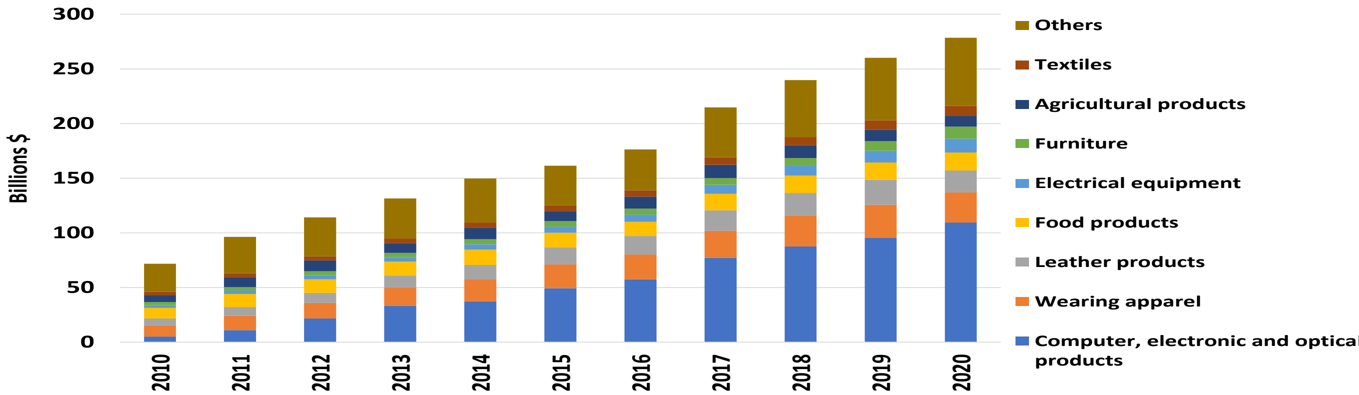
Vietnam has increasingly exported high-tech products

While traditional, labor-intensive manufacturing sectors, such as apparel, footwear, food, and furniture, remain the leading exporting industries in Vietnam, in the last decade, there has been a strong growth in Vietnam's exports from the

[1] The East Asia and Pacific (EAP) region covers 31 countries and Pacific islands, e.g., China, Japan, Malaysia, Indonesia, South Korea, Singapore, Thailand, and Vietnam. USDOS, "Bureau of East Asia and Pacific Affairs," accessed September 3, 2021.

high-tech sector—computer, electronics and optical products (figure 3), primarily driven by communication equipment exports in the sector. This sector also had a high backward GVC participation rate at about 60 percent, indicating low domestic value added and heavy reliance on foreign inputs.

Figure 3 Vietnam's top gross exports, 2010–20



Source: WB, WITS, accessed September 3, 2021.

Vietnam's GVC integration is mostly regional

Vietnam is highly integrated into the regional production network. The EAP countries provided almost 80 percent of Vietnam's imports of intermediate inputs in 2020. China by far was the largest source, followed by South Korea (Korea), Japan, and Taiwan. Vietnam particularly depends on these economies for input sourcing in its key GVC sectors. In 2020, China and Korea provided 95 percent of Vietnam's imported inputs for communication equipment manufacturing. Nearly 30 percent of Vietnam's imports of integrated circuits and related products—the key inputs for electronics—came from Korea, its largest supplier. China, Taiwan, and Japan together accounted for another 44 percent of Vietnam's imports of integrated circuits and related products. In addition, China supplied 61 percent of weaving textile and knitted fabrics to Vietnam, followed by Korea (13 percent), Taiwan (11 percent), and Japan (6 percent). Vietnam's concentrated sourcing from these EAP economies makes it susceptible to supply shocks in the EAP region.

Vietnam export markets are relatively concentrated

Vietnam's exports rely heavily on five markets. In 2020, about 75 percent of Vietnam's final product exports were destined for the United States (37 percent), the EU (19 percent), China (8 percent), Japan (7 percent), and Korea (6 percent). The United States and the EU were the largest markets for Vietnam's exports of communication equipment and computers. The United States was the top market for Vietnam's traditional, labor-intensive, low-tech products such as apparel, furniture, and footwear. China was a major market for Vietnam's seafood and fruit exports, while Japan and Korea were for Vietnam's apparel exports. Vietnam's export performance is vulnerable to demand shocks in these key markets.

The future for Vietnam GVC integration is promising, although it faces constraints

Vietnam was one of the best performing economies under the COVID-19 pandemic in 2020. It is a member of the Association of Southeast Asian Nations (ASEAN) Free Trade Area, and a party to several ASEAN free trade agreements (FTAs), as well as the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), the EU-Vietnam FTA, and the UK-Vietnam FTA. The Vietnamese government has offered aggressive policies and incentives to improve information technology systems, encourage innovation, and promote businesses' participation in high-tech GVCs. However, Vietnam faces several constraints, such as high logistics costs, under-developed domestic supply chains, and a lack of production scale and skilled labor force, which could limit its potential to deepen GVC integration.

Sources: Cushman & Wakefield, "Where in The World?" 2016. Forbes, "IT outsourcing hotspot: Vietnam," May 29, 2018. ITA, "Vietnam—Country Commercial," September 15, 2021. OECD, Trade in value added, accessed September 2, 2021. WB, World Development Indicators, accessed September 2, 2021. WB, Vietnam At a Crossroads, 2017.UNCTAD, FDI inward flows, accessed September 1, 2021. Vietnam Briefing, "How Vietnam's Supply Chains Differ," March 30, 2021.