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As China Rises, So Does Vietnam

A Vietnamese traditional dance was performed at the opening ceremony of an Intel facility in October in Ho Chi Minh City, Vietnam.

One of the biggest beneficiaries of China's rapid economic ascent is not China at all, but rather its historic rival, occasional enemy and fellow socialist neighbor to the south, Vietnam.

Less than a decade ago, many economists and executives believed that China's allure was creating a "giant sucking sound" of investment that could be heard in distant Hanoi and Ho Chi Minh City.

Vietnam has instead managed to tag along, however, thanks to its own program of economic overhauls, a fast-growing population of 87 million people, cheap labor and a free-trade agreement that has enabled Vietnam to become part of the vast global supply chain that feeds China's manufacturing machine.

After following China down the path toward communism after World War II, therefore, Vietnam finds itself back in China's ideological slipstream. This time, Hanoi is driving toward what its calls a "socialist-oriented market economy," largely to keep from being run over by China's economic juggernaut.

"If China had not been there," said Jonathan Anderson, an economist at UBS in Hong Kong, "Vietnam may not have opened up." Vietnam officially reopened its doors to foreign investors in 1986. But it did not really become part of the Asian economic boom until it won back its former enemy, the United States, which lifted a trade embargo in 1994 and normalized trade with Vietnam in 2000.

The U.S. trade agreement provided special incentives to textile and garment makers, since it immediately cut U.S. tariffs on Vietnamese made brassieres and panties from roughly 60 percent to zero. Textile and garment makers from South Korea and Taiwan flocked to Vietnam to open new factories.

Other light manufacturing soon followed, like home appliances and motorbike assemblers, and another industry hitherto dominated by China — furniture. “That whole industry just gradually moved into Vietnam,” said Frederick Burke, a lawyer at Baker & McKenzie in Ho Chi Minh City who has been working in Vietnam and advising its government for more than a decade.

When China joined the World Trade Organization in 2002, however, many feared that Vietnam and indeed much of Southeast Asia’s days as a favored destination for foreign manufacturing investment were over. Some economists even warned that the region would have to surrender manufactured export-led development and instead focus on feeding China’s voracious demand for raw materials.

China signed a free-trade agreement with Vietnam and the nine other members of the Association of Southeast Asian Nations in 2002 that seemed to reinforce such fears. While the agreement gave poorer nations like Vietnam until 2015 to open up to Chinese goods, China eliminated tariffs on their agricultural products in 2003.

The agreement was a boon for Vietnam, which aside from being a leading exporter of rice, pepper and coffee, is a net oil exporter. But as other nations like Singapore, Malaysia and Thailand scrambled to climb the value-added ladder with niche products or more technologically advanced products that enabled them at the least to stay in the race with China, Vietnam seemed destined to become a pantry for a rapidly developing China.

Then China stumbled. Rampant technological piracy, nationalist demonstrations and shortages of skilled labor prompted many foreign companies, particularly Japanese, to move some production back to Southeast Asia. Worse, wages in China were rising fast. “In the late 1990s and early 2000s, you could hire as much labor as you wanted in China. People now talk about rising labor costs,” said Mr. Anderson.

Waiting with its own well-educated, disciplined but much cheaper work force was Vietnam. The minimum wage in Vietnam’s two largest cities is still about $75 a month, as little as half what it costs to hire a worker in China’s factory province of Guangdong, according to Dinh Tuan Viet, senior economist at the World Bank in Hanoi.

This year, Intel opened a new, $1 billion semiconductor factory near Ho Chi Minh City to replace facilities in Malaysia, the Philippines and China. Canon’s printer factory near Hanoi, with more than 18,000 employees, is the company’s largest.

Vietnam has now managed to establish itself firmly in China's supply chain. Many of the parts for Canon's factory come from China, for example, a fact that underscores the downside to Vietnamese efforts to follow in China's manufacturing footsteps — imports of machinery and equipment from China contribute to a roughly $11.5 billion trade deficit with China as Vietnam races to build up its infrastructure and manufacturing capacity.

Now, with China trying to take its next major leap forward into cleaner, more consumer-focused industries, the question is whether Vietnam has gotten far enough to advance in step with China, Mr. Viet said. "Is Vietnam ready and capable of absorbing a new wave of foreign investment resulting from 'structural change' in China?" he asked. "It seems to me there are still a lot of constraints for Vietnam to take this chance: poor infrastructure and an underdeveloped logistics industry, an abundant but unskilled labor force, etc."

For all of China's many obstacles, Vietnam still ranks below it in the World Bank's survey on the ease of doing business.

That survey ranks Vietnam above China in starting a business and employing workers, but below China in protecting investors and enforcing contracts. Vietnam also ranks low on Transparency International's Corruption Perceptions Index — 116th, compared with 78th for China.

Still, Vietnam seems to have won favor as an alternative to China for foreign investors. Foreign direct investment into Vietnam rose almost fourfold between 2005 and 2008, according to the World Bank, to $9.58 billion, and slipped 20 percent during the crisis in 2009 to $7.6 billion. In China it almost halved.