

IS VIETNAM THE NEW ASIAN TIGER? SCOREBOARD AND MACROECONOMIC EVALUATION OF THE ATTRACTIVENESS FOR FOREIGN DIRECT INVESTMENT

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—Abstract—

Following economies like China and India, also Vietnam has managed to increase its attractiveness for foreign direct investments in recent years. In contrast to many European economies Vietnam had overcome the financial and economic crisis in 2008 quickly and turned back to high growth rates already in 2010/11. Nevertheless many European economies and companies still regard Vietnam as an unstable and fragile economy. Therefore the questions arise which general investment conditions are of importance for companies that are investing abroad, and which factors make Vietnam attractive as a business location for foreign companies? After a presentation of stylized facts about Vietnam and a discussion of location theories and location factors, we develop a scoring method to evaluate general investment conditions. Eight of the member states of the European Union in Central and Eastern Europe are used as reference groups to test the scoreboard rating tool, before it is applied for Vietnam.

Key Words: *FDI, Vietnam, country evaluation, macroeconomics*

JEL Classification: **F01, O11, O57**

1. INTRODUCTION

Since the opening of Vietnam's economy, companies from many Western industrialized countries have made foreign direct investments (FDI) in Vietnam. As in China and India, FDI plays an important role in the country's economic development. But while Vietnam is ranked among the top 25 countries for foreign direct investment, it is the only Asian country that dropped in ranking in the A.T.Kearney Foreign Direct Investment Confidence Index from the previous ranking in 2010 to 2012 (A.T. Kearney 2012). This raises the following questions:

- Which factors are important for companies that are investing abroad?

- Which factors make Vietnam attractive as a business location for foreign companies, and where do shortcomings in Vietnam's attractiveness for FDI lie?

In this paper we will first present stylized facts on Vietnam's economic development. After a brief discussion of location theories and location factors, we develop a scoring method to evaluate general investment conditions. Eight of the member states of the European Union in Central and Eastern Europe are used as reference groups to test the scoreboard rating tool, before it is applied for Vietnam.

2. STYLIZED FACTS: ECONOMIC AND SOCIAL DEVELOPMENT IN VIETNAM

Vietnam's economy opened for trade and investments as part of the *Doi Moi* policy (renovation policy) from 1986 (Tsuboi 2007:1). After the economic crisis in Asia in the end of the 1990s, Vietnam experienced strong GDP growth rates from over 6% to up to 8.5% in the period from 2000 to 2008. As a result of the global economic crisis, Vietnam's GDP growth rates dropped, but with 5.3% GDP growth in 2009, already followed by 6.8% in 2010 (World Bank 2012a), the decline in GDP growth was clearly less pronounced than in many Western industrial countries. However, Vietnam's GDP as well as GDP per capita are still lower than those of most other ASEAN countries, with the exception of Cambodia, Laos and Myanmar for both GDP and GDP per capita, and Brunei for GDP (ASEAN 2011a, ASEAN 2001b).

According to the A.T.Kearney Foreign Direct Investment Confidence Index, in 2012 Vietnam is ranked 14th internationally (down from rank 12 in the previous ranking in 2010), behind other Asian economies like China, India, Singapore, Indonesia and Malaysia, but still ahead of for example Thailand and South Korea (A.T.Kearney 2012). Much of Vietnam's growth has been fostered by foreign direct investments (Vierra 2010), but statistics show that FDI inflows to Vietnam have dropped by over 31.5% in the first four months in 2012, while other South East Asian countries like Indonesia and Thailand experienced substantial increases in FDI inflows in the same period, indicating a loss in investor's confidence in Vietnam that is also reflected in the drop in the A.T.Kearney FDI Confidence ranking (Vietnam Investment Review 2012).

Trade has increased approximately four-fold from 1990 to 2010 (General Statistics Office of Vietnam 2012), and in the years 2007 to 2011 exports grew between 8.9% and 34.2% per year (Asian Development Bank, 2011). However,

Vietnam has had a negative trade balance in most years in these two decades. In 2011 the trade deficit is estimated to amount to EUR 6.3 billion (European Union DG Trade, 2012). Inflation measured by the CPI has been highly volatile, with rates between 6.9% and 23% in the last five years. In 2011 inflation was at 18.7%. (Asian Development Bank, 2011). In 2011 the government set out to shift the focus of its economic policies away from economic growth towards tightened monetary and fiscal policies to tackle the inflation problem (Central Intelligence Agency 2012). Unemployment has been at stable low rates of under 5% from 2007 to 2010 (Asian Development Bank, 2011). Poverty rates (national poverty line) have dropped significantly in recent years, from 37.4% in 1998 (World Bank, 2012b) to 14.5% in 2010 (Central Intelligence Agency, 2012).

3. THEORETICAL BACKGROUND

3.1. Indicators for location decisions

The most common motives for foreign direct investment are a reduction of costs, access to new markets, following the customer, access to new technology, and access to raw materials (Kinkel, 2003: 43-46). Regardless of the specific motive, a wide range of indicators can be taken into account to evaluate the general climate for doing business and investing in a country. Indicators with a focus on production costs can be considered part of the neoclassical approach, which focuses on finding the investment location with the lowest costs and where the respective company can achieve the highest profits. However, a focus on cost factors alone ignores important framework conditions like e.g. government policies, infrastructure and aspects of the labor market beyond labor costs, which the structural approach takes into consideration (Maier, Tödting, 2006: 24-35). In this paper we integrate both neoclassical and structural factors in our analysis to give a comprehensive overview over the investment conditions in foreign markets.

3.2. Project based approach and country classification analysis

Numerous studies (see among others Kinkel and Buhmann 2004: 32-34) focus on crucial qualitative and quantitative indicators to determine the attractiveness of an economy or a region for investments. Studies which base the benchmarking-process on such country specific characteristics frequently follow a project based approach. Using this approach, which has been described in detail by Frenzel (2006) and which has been critically evaluated by Homlong and Springler (2009), the characteristics of a specific economy are combined with determinants of foreign direct investment (see 3.1.). This enables a specific country ranking. While the project based approach presented by Frenzel (2006) includes nine sub-

categories of variables, which are weighted by detailed percentage points, this paper follows a scoreboard analysis, in which the categories given a weighting from 1 to 3 according to their importance for FDI attractiveness. The reasons for this modification are described in detail in Homlong and Springler (2009).

4. MODIFICATION OF THE PROJECT FOCUSED APPROACH: SCOREBOARD MODEL

Applying the project based approach, we use five categories of indicators to evaluate the attractiveness of Vietnam as a business location for foreign companies (see table 1).

Table-1: Scoreboard Indicators

Categories	Weighting
Economic conditions	3
<i>GDP per capita in %</i>	
<i>GDP growth in %</i>	
<i>Inflation in %</i>	
Political security	2
<i>Corruption Perceptions Index - Score</i>	
<i>Control of Corruption Index - Score</i>	
Political development	1
<i>Voice and Accountability Index - Score</i>	
<i>Government Effectiveness Index - Score</i>	
Infrastructure	3
<i>Roads paved % of total roads</i>	
<i>Broadband users per 1,000 persons</i>	
<i>Mobile users per 1,000 persons</i>	
Factor Capital	1
<i>corporate taxes % of total taxes</i>	
Total score	10

Source: own presentation following the analysis in Homlong and Springler, 2009.

These categories represent stability and potential of an economy from economic, political and structural points of view. In the category *economic conditions* three indicators are used to describe economic stability and the potential for growth: GDP per capita, GDP growth and the inflation rate measured by the consumer price index. Fluctuations in the inflation rate as a sign for instability are not taken into account. Given the importance of this category it gets a high weighting of 3. The category *political security* focuses on the perception and control of corruption, which is of specific importance for FDI in Asian economies (see

Homlong and Springler, 2009), and is weighted with 2. Compared to this *political development* in terms of accountability and effectiveness of governmental decisions is less important and weighted with 1; the same weight is applied to the category *capital*, which is determined by the ratio of corporate taxes, compared to total taxes applicable in the economy. Aspects of structural development are considered important and are therefore weighted with 3; these are included in the category *infrastructure*, which includes transport infrastructure (road networks) as well as the use of modern technology (broadband internet and mobile phones).

The total score of this analysis is 10, which represents the highest level of attractiveness. As this method leads to a relative ranking of an economy in terms of FDI attractiveness, a benchmark economy or region is required. In the case of this paper the benchmarking-regions used for the evaluation presented in part five are EU15 and EU25 member states. The rationale for this choice is that these 'new' EU member states have been major recipients of FDI from the 'old' member states of the EU (EU15). But especially since the economic crisis of 2008 many companies in 'old' member states of the European Union are looking for new markets or new locations for production, and this analysis is to give insight into the attractiveness of Vietnam for FDI inflows from European economies compared to the new EU member states.

5. EVALUATION OF THE SCOREBOARD METHOD FOR FDI IN VIETNAM

As described above, the attractiveness of Vietnam for foreign direct investment is measured in relation to EU15 and EU25. To apply data which is business-cycle neutral, the data used for *economic conditions* and *capital* is the average of 2006-2009 for Vietnam compared to 2001-2005 for EU15 and EU25. The reason for these differences in data is due to the fact that especially for the comparison of Vietnam to EU25 in terms of attractiveness, it seems reasonable to compare time periods where the perception of attractiveness was high and no international financial crisis hit the economy. Vietnam could overcome the current international economic crisis without major downturns in economic conditions. When it comes to political security and political development, the same time period 2006-2009 is used for all economies in the scoring.

The ranking is conducted by comparing the sum of the average results for the respective time period for Vietnam for the individual variables in the categories as percentages of the reference regions EU15 and EU 25. The results of the variables were added. Whenever Vietnam reaches 100% of the score of the reference region, full points are given. The maximum cannot be exceeded. Similarly 0

points are the minimum for poor performance, no negative points are given. Therefore the score 0-10 presented in table 2 reflects the relative attractiveness of Vietnam compared to the two regions EU15 and EU25.

Table-2: Scoreboard Ranking

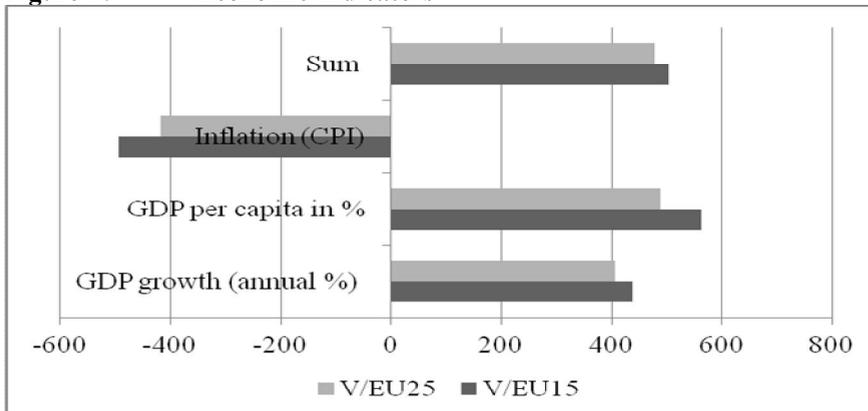
Groups	Ranking	Vietnam EU15	Vietnam EU25
<i>Economic conditions</i>	3	3	3
<i>Political security</i>	2	0	0
<i>Political development</i>	1	0	0
<i>Infrastructure</i>	3	1	1
<i>Factor Capital</i>	1	1	1
Total score	10	5	5

Source: own calculations.

The ranking as presented in table 2 shows that Vietnam has a medium position compared to EU15 and EU25. This is mainly due to the poor results in the categories political security and development. Also in structural terms Vietnam is still lagging behind.

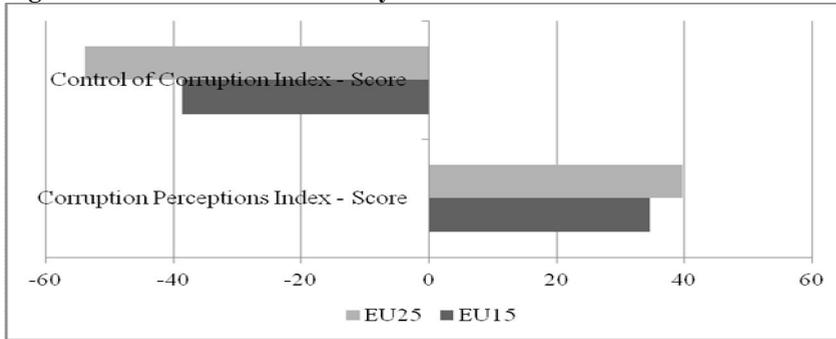
Figure 1 shows the detailed results in the category *economic indicators*. Vietnam shows high potential in terms of GDP growth and GDP growth per capita, but has high (and unstable) inflation rates. E.g. compared to EU15, annual growth rates were four times higher, but consumer price indexes also. Despite of high inflation there is a very good investment climate in Vietnam when it comes to economic conditions, therefore the full 3 points are given.

Figure-1: Economic Indicators



Datasource: World Development Indicators; own calculations.

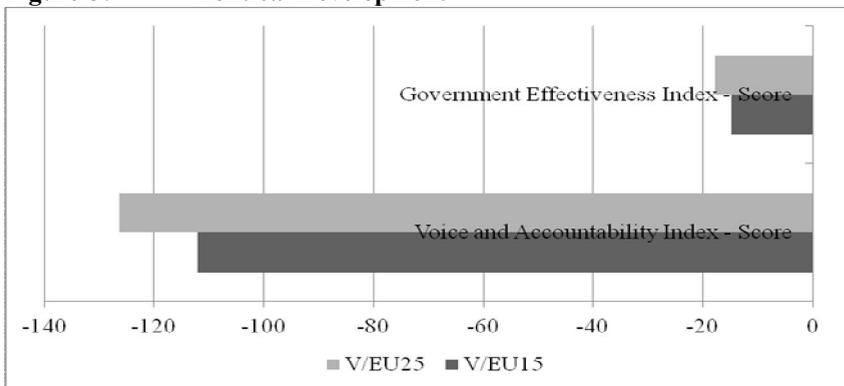
Figure-2: Political Security



Datasource: Global Market Information Database; own calculations.

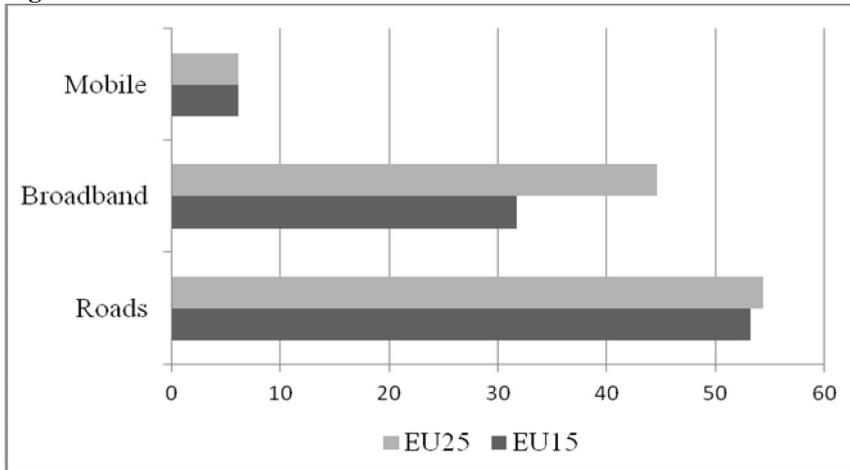
The results for *political security* and *political development* were very poor. As figure 2 shows, the control of corruption index was negative in the last years, which means that the control of corruption did not improve, but rather diminished. Therefore also the ratio in relation to the reference regions turned negative. Also the score for the corruption perception index is still very low (meaning higher corruption in Vietnam compared to EU15 and EU25) and comes to only 40% compared to EU25 and about 34% compared to EU15-levels. A similar situation was observable in terms of *political development*. Neither the accountability index nor the effectiveness index improved and led both to negative results in the respective period. This means that following the data of the Global Market Information Database, managers and other persons affected do neither believe that governmental rules are effective in improving the situation of entrepreneurs, nor can anybody be held accountable.

Figure-3: Political Development



Datasource: Global Market Information Database; own calculations.

Figure-4: Infrastructure



Datasource: World Development Indicators; own calculations.

Compared to the poor results when it comes to governmental accountability, aspects of *infrastructure* and structural change show high dynamics, but also mark clearly that Vietnam is still lagging behind. In the observed time period the average number of mobile phone users accounted for only 6% of EU15 and EU25 numbers, but was strongly increasing. Also in terms of broadband users Vietnam is lagging behind. Here also the differences between EU15 and EU25 become evident. Vietnam holds 44% of the share of broadband users compared to EU25 and only 31% compared to EU15, but also here the development in Vietnam is highly dynamic.

6. CONCLUSION AND OUTLOOK

As the analysis showed, economic indicators for Vietnam are mostly favorable, and developments in infrastructure are going in the right direction towards making Vietnam more attractive for FDI. However, when it comes to government effectiveness and corruption, there are clear needs for improvements. These aspects can make FDI in Vietnam more risky and time-consuming and can thereby deter especially SMEs from making investments in Vietnam – also because other Asian countries display similar advantages as Vietnam in economic terms, with better conditions with respect to political security and development.

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