

# INTERNATIONAL AND STRATEGIC STUDIES REPORT



MAR 12, 2019

ISSUE. 77

Institute of International and Strategic Studies, Peking University

## **Strengthening Economic Diplomacy towards Vietnam to Address Changes in International Economic Environment**

**Li Wei**

**Professor at the School of International Studies and Research Fellow  
at the National Academy of Development and Strategy, Renmin  
University of China**

In 2018, there were constant economic disputes between major powers, which led to an impending crisis of the WTO and commencement of several mega free trade agreements (FTAs). The global trade order was severely impacted. For a number of reasons, Vietnam has risen in status in the international economic landscape during this process. In this new situation, China needs to comprehensively strengthen economic diplomacy and economic cooperation with Vietnam in order to withstand adverse effects generated by the deteriorating international economic situation.

### **I. Vietnam has significantly risen in status in the international economic system**

Since 2018, Vietnam, as a small developing country, has surprisingly

risen in status in the international economic landscape in the complicated international economic situation, which is manifested in the following two aspects:

First, Vietnam is becoming a new “paradise” for developed countries transferring their processing and manufacturing industries there, and its role of contract manufacturing in the global value chain has become increasingly prominent. The China-U.S. trade friction has seriously hindered some Chinese products from being exported to the U.S. The multinational companies that have invested and set up factories in China are deeply uncertain about the future, and are looking for new manufacturing and processing bases to avoid high tariffs set by the U.S. against China. In addition, China’s manpower and environment costs are on the rise. There is a view that the fourth round of global industrial transfer is emerging, and Vietnam is one of the main destinations of this round of industrial transfer. The momentum of rising of its status in the global industrial chain should not be underestimated.

In traditional industries such as clothing, the production capacity of multinational companies such as Nike and Adidas in Vietnam has exceeded the capacity of Chinese contract manufacturers, and this trend will become more apparent after 2018. In high-tech industries such as electronics, some multinational companies have begun to turn to Vietnam. Samsung, LG, and Microsoft already have a variety of products manufactured in Vietnam. Apple has also established a wholly-owned subsidiary and an Asian R&D center in Vietnam. Mitsui O.S.K. Lines, one of Japan’s largest shipping companies, has invested in a container port expansion project in Vietnam, which is said to be aimed at coping with the increasing production capacity multinational manufacturers have transferred from China to Vietnam.

The key comparative advantage of Vietnam that attracts processing and manufacturing investors is the country’s low labor costs and strong economic growth momentum. At present, the average monthly salary in

Vietnam is only 31% of the salary in China. The labor force accounts for about 60% of the country's total population, and the overall population is young. In addition, since the Doi Moi (the economic reforms initiated in Vietnam in 1986), Vietnam's domestic economy has grown by leaps and bounds. Its GDP growth rate over the past three years has remained between 6% and 7%. The economy with a strong growth momentum has not only created driving force for the development of its domestic manufacturing industry, but also instilled confidence into foreign investors. Moreover, Vietnam's political situation has been relatively stable in recent years, and the Vietnamese leadership has actively adopted a foreign-investment-friendly policy to develop the country's economy.

Second, with the EU-Vietnam Free Trade Agreement (EVFTA) and the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) coming into force, Vietnam's status of a "hub" in the global free trade network is becoming increasingly prominent. Under the framework of these two major FTAs, Vietnam, though a developing country, can enjoy the benefits given by developed economies such as the EU and Japan and achieve better connectivity with developed markets. Besides, the two FTAs represent free trade rules of higher level at present (for example, after the EVFTA coming into force, the two sides will phase out up to 99% of the tariffs on goods), which may become "templates" for negotiations of FTAs. From this perspective, Vietnam, as a negotiating party, has been actually given the opportunity and power to participate in the formulation of new global free trade rules during negotiations of the two agreements.

In fact, since the beginning of the 21st century, Vietnam has been actively promoting the free trade area negotiations. As of November 2018, the country has participated in twelve free trade areas, and another four are in the process of negotiation. It has signed FTAs with the world's major economies such as ASEAN member countries, China, Japan, South Korea, India, Australia, the EU, the Eurasian Union (EAU),

etc. Through these efforts, Vietnam has built a vast free trade network and gained a huge and stable international market, which can effectively resist the impact of the wave of protectionism. It has also erected a bridge of communication for rule-making between developing countries and developed countries, and has become a “hub” for linking two types of economies in terms of market connectivity.

## **II. Recommendations for further development of China’s economic diplomacy towards Vietnam**

In the current turbulent international economic environment, China, as the world’s second largest economy, is facing greater pressure to maintain and expand economic cooperation with foreign countries. In this regard, China needs to further strengthen its status of a “big country of manufacturing” by further improving its investment environment and continue to keep opening to the outside world, China also needs to increase its pace toward a “manufacturing powerhouse”. Moreover, in the context of Vietnam’s rising international economic status, it is necessary to attach great importance to the strengthening of China’s economic diplomacy towards Vietnam and to use Vietnam as one of China’s “sally ports” to break through the current international predicament.

First, China should attach importance to our relationship with Vietnam from a strategic perspective and shift the focus of bilateral relations from the South China Sea issue to economic cooperation. Although the dispute over the South China Sea has not made a serious impact on China-Vietnam economic cooperation since 2014, however, since 2018, judging by Vietnam’s words and deeds that aim at drawing the U.S., Australia, India, and other countries over to Vietnam’s side on the South China Sea issue, it is still a potential obstacle to further development of the China-Vietnam relations. In order to better grasp the current dividends that may arise from the Vietnam’s rising international economic status, China may consider weakening the South China

Sea issue in the diplomacy towards Vietnam, and jointly guide the focus of bilateral relations from territorial and maritime disputes to economic cooperation with Vietnam on the premise of ensuring China's sovereignty and territorial integrity, reducing the uncertainties in China-Vietnam relations.

Second, China should research into and launch the China-Vietnam FTA negotiations, in order to join a broader free trade network and conform to free trade standards of higher level. As Vietnam is a much smaller economy than China, substantially opening the market to Vietnam will not create much impact on the same type of industries in China. On the contrary, because Vietnam itself is in a wide-ranging free trade network, signing a free trade agreement with Vietnam means that China can indirectly enter developed markets such as the EU and Japan through Vietnam, thus greatly expanding China's overseas market. In addition, Vietnam's geographical advantage gives it considerable potential for becoming a "transfer station" for emerging international trade following Hong Kong and Singapore. In the context of intensified trade frictions between major powers, Vietnam can provide an entrepot trade platform for export of China's products to other major countries. On the other hand, China is Vietnam's largest trading partner. In 2018, the bilateral trade volume exceeded 100 billion U.S. dollars, accounting for more than one-fifth of Vietnam's total foreign trade. This is another favorable condition for starting negotiations with Vietnam on a free trade agreement.

At present, China and Vietnam have jointly participated in the China-ASEAN FTA and its upgraded version. The agreement has eliminated nearly 100% of the general merchandise tariffs between China and Vietnam, and the tariffs on sensitive goods have also been reduced to less than 50%. The key to the China-Vietnam FTA negotiations is how to surpass the China-ASEAN FTA and its upgraded version. In this regard, the EVFTA, the CPTPP, and the upgraded version of

the China-Singapore FTA signed in 2018 can be the reference for the China-Vietnam FTA negotiations. In addition to traditional issues such as reducing tariffs on import and export goods, the above-mentioned three FTAs also attach great importance to negotiations of emerging issues such as service trade, investment cooperation, trade remedy, and labor rights and standards. These agreements also require signatories to make corresponding adjustments in the content and form of domestic legislation and law enforcement, government administration, and social governance. These agreements represent in a certain sense the latest content and higher level of current global free trade rules. China-Vietnam FTA negotiations should also focus on the above issues (especially investment and cooperation), while trying to make convergence towards stricter rules and higher standards to integrate China into new global free trade rules, so that level of free trade between China and Vietnam is improved, economic integration of China and Vietnam is promoted, and China's position at the center of global free trade is ensured.

Third, China should encourage some Chinese enterprises to invest in setting up factories in Vietnam in order to avoid high tariffs some countries imposed on China. China's investment in Vietnam grew later in time and smaller in scale compared with its investment in countries such as Japan, South Korea, and Singapore. Yet China should also pay considerable attention to Vietnam under the new international economic situation, especially when Vietnam has become an attractive place for international investment. Accelerating the investment layout of Vietnam can create more substantial benefits for China. On the one hand, China can leverage the comparative advantage of low labor costs in Vietnam and turn them into price advantage of products, so that while the products become more competitive in the local market, the influence of Chinese brands could be extended. On the other hand, China can transform some Chinese products from "made in China" to "made in Vietnam" to effectively avoid the high tariffs set by other major powers against China. Vietnam's huge free trade network is also conducive

to the extensive expansion of overseas markets for Chinese products. During the Japan-U.S trade friction, Japan evaded the America's high tariffs on its products by transferring production lines to Thailand. In addition, both Chinese-funded enterprises and foreign-funded enterprises will inevitably push the upgrade of China's industrial structure to a certain extent in the process of industrial transfer to Vietnam and promote the transformation of China's role in the global industrial chain.

Fourth, China should strengthen financial cooperation with Vietnam and broaden the scope of bilateral economic and trade cooperation, providing a better financial supporting environment for China-Vietnam trade and investment activities. Specific measures are: (1) accelerating the negotiation and signing (or establishment) process of China-Vietnam currency swap and currency clearing mechanism to promote settlement in local currency and reduce the dependence on the U.S. dollar, thus reducing the risks brought by fluctuations of the Vietnamese Dong's exchange rate against the U.S. dollar; (2) encouraging and helping more Chinese-funded banks in entering Vietnam and providing better financial services for Chinese enterprises to invest in Vietnam, assisting Chinese mobile payment companies in entering Vietnam; (3) establishing a financial dialogue mechanism between the two countries at the vice premier level to promote regular meetings between the two ministries of finance and central banks and exchange views on deepening financial cooperation between the two countries.

Fifth, China should comprehensively strengthen people-to-people exchange and personnel exchanges between the two countries to lay a social foundation for the long-term stability of bilateral relations. Due to historical and other reasons, there are still many factors that lead to distrust in civil society of the two countries. In this regard, China needs to vigorously carry out public diplomacy towards Vietnam to promote people-to-people exchange between the two countries, in order to resolve negative sentiments between them. Specific measures are as follows: (1) vigorously promoting Chinese tourists' traveling

to Vietnam to enhance mutual understanding. The number of Chinese tourists hosted by Vietnam accounts for one-third of the total number of international tourists in Vietnam, and the number is growing very fast. It is an important factor that promotes China-Vietnam economic relations; (2) providing scholarships for Vietnamese students to attract more outstanding Vietnamese students to study in China, setting up more Confucius Institutes in Vietnam, and increasing support for Chinese studies in Vietnam; (3) determination to solve the “Vietnamese bride” issue and encourage legal intermarriage between residents of the two countries.

Edited by Dr. Gui Yongtao and Dr. Anastasiya Bayok

Tel: 86-10-62756376

Email: [iiss@pku.edu.cn](mailto:iiss@pku.edu.cn)

Fax: 86-10-62753063

Web: [www.iiss.pku.edu.cn](http://www.iiss.pku.edu.cn)

Address: IISS, Peking University, Beijing, China