

ARGO ASSOCIATES

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The Future of Vietnam – Risks and Opportunities

Perhaps surprisingly given its Communist history, Vietnam has deliberately bound its economic strategy to the key institutions of open global commerce, and in recent decades it has been a notable beneficiary of free trade. A cheap labour force, attractive tax and investment schemes, growing free trade agreements (FTAs), and pro-investment local governments have all attributed to large amounts of manufacturing investments. As a result, the country has become deeply embedded in global value chains as a manufacturing powerhouse. Indeed, since joining the WTO in 2007, Vietnamese exports have significantly increased, from USD45 billion in 2006 to more than USD127 billion in 2017. During the same period, merchandise trade also leapt from 127% to 190% of GDP, placing Vietnam only slightly behind its Southeast Asian counterpart Singapore (206%).

Trade War Winner?

When US President Donald Trump in mid-2018 launched a tariff war against China, many wondered what it would mean for Vietnam. Despite the claims of some commentators the situation is a mixed blessing for Vietnam. The shift of some manufacturing activity from China to Vietnam will be mostly advantageous but the dispute also inevitably affects Vietnam's crucial position within the international free trade system and has adverse effects on several economically important Vietnamese industries (including seafood and steel). In addition, Vietnamese capacity in terms of factories and infrastructure is already stretched and additional production will, at least in the short term, increase land prices and create some bottlenecks.

Nonetheless, the reality is far more complex than either position suggests - the movement of some manufacturers from China to Vietnam is part of a structural change that was already underway and cannot be solely attributed to the effect of US tariffs. Cost-driven decisions by many firms and China's tightening environmental regulations have in recent years driven many China-based firms to relocate their operations into Southeast Asia, including to Vietnam, well before the US-China trade war started this year. Furthermore, wages in Vietnam are comparatively cheap (ranging US\$120-\$170 per month) compared to China; by contrast, wages in Guangdong are around US\$300 in Guangdong (albeit this depends on location).

Still, wages are not the sole crucial factor for companies; Trump's pullout from the previously much-anticipated Trans-Pacific Partnership agreement (TPP or now rebranded as CPTPP, excluding the US) also halted the momentum of a spike of Vietnam-inbound investments, following USD5 billion in garment and textiles investment that had flowed into Vietnam hoping to benefit from the TPP.

Downsides

Although Vietnam has gained greatly from its strategy of open trade and investment, it is uncertain how this strategy will play out in coming years. Although Vietnam's manufacturing exports are on the rise and it stands to benefit as businesses seek lower cost, ex-China alternatives, the importance of exports to Vietnam's economy could also represent a risk, especially if the international trading system is destabilized or undermined through a continued trade war.

Even if the trade war brings some benefits, too much success could prompt unwelcome scrutiny of Vietnam's trade surplus with the US (USD32 billion as of 2017) – an issue for Trump who has been trying to reverse such trends with many countries, leading to bilateral trade tensions. US-Vietnam trade friction was only parried in 2017 through

Vietnamese Prime Minister Nguyen Xuan Phuc's well-orchestrated visit to the White House in Washington and some savvy, high-profile buys of US airplanes and other big-ticket items. Friction could easily revive if President Trump were to go looking for further international trade demons.

The CPTPP is thus highly appealing to reduce structural deficits and increase domestic value, which is currently a key economic priority for Vietnam, because it would offer preferential treatment for goods produced within the bloc, which would help Vietnam cut its structural trade deficits through the in-sourcing of upstream industries. The flipside, if the trade war pushes Chinese players into Vietnam, is that this could yield negligible progress on the ongoing Vietnam-China structural deficit while further provoking the US, due to an increase in the US-Vietnam trade deficit and Vietnam-produced exports.

Just like China?

Still, much work remains to translate this investment up the value chain so it is linked to the domestic real economy and does not simply worsen structural deficits with markets like China. An old aphorism holds that 'Vietnam follows China, just a decade behind'. Both, China in the 1970s and Vietnam in the 1980s, addressed impending economic crises through liberalisation of their agricultural sectors and trade regimes before then creating dual track systems for private and state capital. Both countries also joined the main institutions of global commerce (most notably the WTO), concluded multiples FTAs, and dramatically expanded trade with the US. More so than in China, for Vietnam this resulted in a greater opening up to foreign trade and investment.

Indeed, the Vietnamese economy suffers from a dearth of mid-sized firms, partly because so much of the economy is oriented towards exports that are produced with largely imported inputs and technologies. So, although Vietnam is deeply embedded in international value chains, the openness of its trade regime means it is too easy to simply use the country's cheap labour or competitive tax regime as the main component in their production. Furthermore, in addition to the inevitability that wages will eventually rise in the future the lack of mid-sized firms substantively limits the potential development of a host of other sectors, most notably in the financial sector. The lack of mid-sized firms means that foreign investors have seen the country as being good for production and assembly but private equity investment and corporate M&A from foreign companies has been limited considering Vietnam's overall growth record.

It's all about politics and corruption

Part of the reason for the lack of decent mid-sized firms is that much is needed to improve Vietnam's fragmented and inefficient governance. The recent consolidation of the authority of the Party General Secretary and State President Nguyen Phu Trong (following the death of the previous incumbent), is unprecedented and has the potential to mark the beginning of a new and muscular intervention of the party into Vietnam's state institutions. Rather than a pure emulation of China under Xi Jinping, this demonstrates Vietnam's struggles with low-quality, uncoordinated governance, and the Party's deep concerns about corruption. The change highlights the party's worry about the potential erosion of its authority through high-levels of corruption (in recent years Trong has been the Party's strongest force against corruption), rather than a fundamental change in the country's political economy. With greater political and economy centralization, enhanced governance, and coordinated industrial development, Vietnam is likely to benefit far more from future trade and investment.

About Argo Associates

We seek to provide our clients with the information and intelligence that will allow them to navigate acquisitions, investments, disputes, or frauds in a clear-sighted and rational way, minimizing risk and maximizing opportunities.

Information gathered may clarify the profile and background of key business people and managers; it could illuminate the operations of a company or demonstrate a history of fraud or mismanagement; or it could help our clients to assess the political situation in a given jurisdiction and how it may affect their investments or business operations.

Headquartered in Hong Kong, Argo Associates assists clients across Asia and – through international partners – globally.

Intelligence Gathering

“Intelligence” is central to making sense of the world and to decision-making. Argo Associates has developed a network of well-placed human sources across Asia and – through our partners outside Asia – globally. This network provides insights beyond what is available publicly – into leadership, operations, strategy, corruption, red flags, political connections and so on - and is supplemented by extensive research and analysis of publicly available sources – corporate filings, litigation filings, regulatory communications, media articles, social media postings and so on. In a world in which information is increasingly commoditized, high-level intelligence and analysis provides the insights that give our clients an edge over their competitors.

Fraud, Corruption and Disputes

Our intelligence-gathering techniques and in-depth research and analysis have also helped our clients uncover frauds within their operations or in those of a portfolio company or recent acquisition. Our professionals have provided numerous reports for arbitration or legal proceedings to recover the proceeds of fraud. We have also assisted clients in tracing assets globally when bringing a high-value claim against a company or individual. In high-profile disputes we have assisted top law firms in gathering information, evidence and intelligence in support of their clients’ cases.

Political Risk

Our political risk work has developed naturally out of our intelligence and investigative capabilities. We see political risk as an important part of the evaluation of many investments, mergers and acquisitions, as well as a key element of commercial disputes in many markets. We have helped our clients look at political risk in a new way, not just in terms of the broad outline of potential political developments in various countries, but with a focus on the impact on their businesses. For example, will growing frictions between two countries lead to tariffs that could impact the specific sector in which a portfolio company operates? Or, how will rising protectionism in a country alter the possibility of a fair result in an ongoing commercial dispute? Frequently, politics is local as much as national and we understand the importance of drilling beneath the widely-circulated opinions to a real understanding of what is happening.



Jason Wright, Managing Director of Argo Associates

Prior to founding Argo, Jason was a Managing Director in Hong Kong for Kroll. Before moving to Asia in 2011 he worked for Kroll in Italy for five years and then briefly in London.

In addition to assisting clients on numerous transactions, investigations and disputes in Asia and Europe, - particularly private equity funds, banks, hedge funds and special situations investors - Jason has also specialized in the analysis of political risk, whether that has involved examining the role of local politicians, regulators and other stakeholders, or broader geopolitical concerns.

Although he has managed projects across the whole Asia-Pacific region he has been particularly focused on China, Korea, and Southeast Asia, especially Indonesia, Vietnam, Malaysia and Thailand.

Jason is a scholar of St. Catherine's College, Oxford, having been awarded a Master of Arts (Oxon) in English Language and Literature, as well as a Master in State Management and Humanitarian Studies from La Sapienza University in Rome, Italy.

Lina Gautama, Director

Lina Gautama is a South-East Asia expert, focusing particularly on Indonesia, Malaysia and Thailand. An Indonesian national, she has advised clients on political, commercial and integrity risks across the region.

As well as handling complex investigations in sectors such as mining, oil and gas, and the automotive industry, Lina has also delivered anti-bribery and anti-corruption assessments for foreign investors and overseen pre-transaction investigative due diligence projects across the region.

Prior to joining Argo Associates, Lina worked with Control Risks, Keppel and ConocoPhillips. She holds a bachelor's degree in Business from Singapore Management University. Lina is fluent in Bahasa Indonesia, Bahasa Melayu and Mandarin, and speaks some French, Spanish and Thai.



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