EVFTA, EVIPA AND VIETNAM'S INTEGRATION IN GLOBAL VALUE CHAINS IN A POST-COVID 19 WORLD

ROUNDTABLE
READER

Hanoi, September 2020

Delegation of the European Union to Vietnam

EVFTA, EVIPA AND VIETNAM'S INTEGRATION IN GLOBAL VALUE CHAINS IN A POST-COVID 19 WORLD

A Reader Prepared for Roundtable Series on EVFTA, EVIPA and Post-COVID-19 Economic Recovery in Vietnam

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Hanoi, September 2020

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TABLE OF CONTENTS

TABLE OF FIGURES

ABBREVIATIONS

GVC	Global Value Chain
EU	Europe Union
EVFTA	The EU-Vietnam Free Trade Agreement
EVIPA	The EU- Vietnam Investment Protection Agreement
FTA	Free Trade Agreement
VPF	Vietnam Partnership Facility
FVA	Foreign value-added
DVA	Domestic value-added
DVX	Domestic value-added incorporated in other countries' exports
FIE	Foreign Invested Enterprises
MNE	Multinational Enterprises
GDP	Gross Domestic Products
WDI	World Development Indicator
US$	United State Dollar
US	The United States
SME	Small Medium Enterprise
WTO	World Trade Organization
CPTTP	Comprehensive and Progress Agreement for Trans-Pacific Partnership
VCCI	Vietnam Chamber of Commerce Industry
PCI	Provincial Competitiveness Index
ASEAN	Association of Southeast Asian Nations
MOIT	Ministry of Industry and Trade
ICT	Information and Communication Technology
MNC	Multinational Corporation
GSO	General Statistics Office
PTA	Partnership Trade Agreement
CIEM	Central Institute of Economic Management
R&D	Research and Development
STEM	Science, technology, engineering, and mathematics
CTM	cut, make, and trim
FOB	Free on Board
TPP	Trans-Pacific Partnership

INTRODUCTION

For more than three decades, the Vietnamese economy has gradually opened from a closed economy to one of the most integrated economies in the world. Currently, the EU is one of the largest trade and investment partners of Vietnam and will continue to strengthen this role in the future.

The COVID-19 pandemic has caused unprecedented health and economic crisis worldwide. With COVID-19, some argue that GVCs create additional economic vulnerabilities during a pandemic or other crisis where international trade is disrupted. COVID-19 is a global health crisis that has led governments and companies to take exceptional measures to protect the lives of citizens and workers. These measures have either reduced or stopped the economic activity, resulting in decreased output, rising unemployment, and falling demand. Both the EU member states and Vietnam are taking proactive measures to revitalize the economy in the aftermath of the pandemic.

The EU-Vietnam Free Trade Agreement (EVFTA) was first ratified by the EU and then by the National Assembly of Vietnam, in the midst of the pandemic. After the completed ratification, the EVFTA entered into force on 1st of August 2020. This historical agreement brings hope and new growth opportunities to both parties of the agreement. Once fully implemented it will contribute to economic recovery in a post-COVID world. Whilst foreign direct investment (FDI) is already fully covered by the EVFTA, the EU-Vietnam Investment Protection Agreement (EVIPA) will provide enhanced protection for the EU investors and investments once the EU finalizes its ratification. Vietnam has already ratified the EVIPA together with the EVFTA.

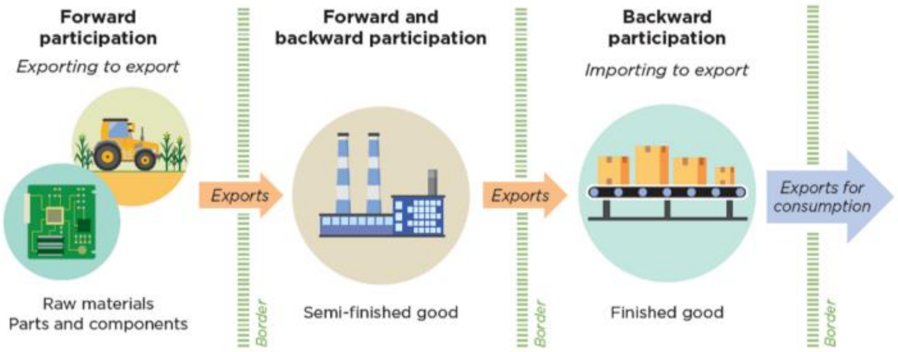
The EVFTA is a new generation FTA between Vietnam and the European Union. It is a comprehensive and high-quality agreement that ensures balanced benefits for both Vietnam and the EU, with consideration for the differences in development levels between the two sides. Upon entering into force, the EVFTA is expected to boost Vietnam's exports to the EU and also to help to diversify markets for buying inputs and supplies as much as exports of semi-processed and finished products. It also opens the Vietnamese market to European products and services. Higher EU exports to Vietnam are also likely to spur a higher interest in Vietnam as a destination for high-quality foreign direct investments from the European Union.

In such a context, the EU Delegation to Vietnam organizes a series of roundtables on economic and business development in the context of a post Covid-19 world and of the EVFTA. The first of the series is with the theme “The EVFTA and Vietnam’s integration in global value chains in a post-COVID 19 world”. The roundtables are to be implemented by EU Delegation in Vietnam under the framework of the EU-Vietnam Partnership Facility (VPF). The reader which is prepared by Dr. Le Duy Binh and Dr. Tran Thi Phuong of Economica Vietnam and GOPA is to provide background information for the roundtable.

1. What is Global Value Chain?

A Global Value Chain (GVC) involves the fragmentation of production across countries. Backward participation involves importing foreign inputs for processing and further export. Forward participation involves exporting inputs that are incorporated in the exports of other countries.

Figure 1 - What is a global value chain?



Source: *World Development Report, World Bank (2020)*

As the figure shows, participating in GVC involves trading across the border(s) and in transacting with international buyers and firms. Globally, over two-thirds of world trade occurs through global value chains (GVCs), in which production crosses at least one border before final assembly.

Main GVC indicators

- *Foreign value added (FVA):* FVA indicates what part of a country's gross exports consists of inputs that have been produced in other countries. The FVA share is the share of the country's exports that do not add to its GDP.
- *Domestic value added (DVA):* DVA is the part of exports created in-country, i.e. the part of exports that contributes to GDP.
- *Value added incorporated in other countries' exports (DVX):* This indicates the extent to which a country's exports are used as inputs to exports from other countries.
- *GVC participation* specified the share of a country's exports that is part of a multistage trade process, by adding to the FVA used in a country's own exports the value added that is supplied to other countries' exports. Although the degree to which exports are used by other countries for further export generation may appear less relevant for policymakers, as it does not change the DVA contribution of trade, the participation rate is a useful indicator for the extent to which a country's exports are integrated in international production networks.

Source: *Adapted from UNCTAD (2013)*

A country's exports can be divided into domestically produced value added and imported (foreign) value, and incorporated into the country's exported goods and services. Furthermore, exports can go to a foreign market either for final consumption or as intermediate inputs to be exported again to third party countries (or back to the original country). The analysis of GVCs takes into account both foreign value added in exports (the upstream perspective) and exported value added incorporated in third-country exports (the downstream perspective).

Production processes are nowadays structured in several stages, which often take place in more than one country. To manufacture a final product, firms source intermediate inputs from a number of providers, and in many cases, these providers are located abroad. Value is added at each stage of the production process, and products might cross borders several times before being finally consumed.

Efficiency motives and cost considerations are amongst the factors considered behind the decisions taken by firms to use foreign inputs or to locate production stages – including final assembly – overseas. Research and development of the smartphone might take place in an economy with specific competitive advantages, while the final product is assembled where labor costs are comparatively low, and components are provided by countries that specialize in producing them. Each of the countries involved in the production process contributes – albeit in different proportions – to the total value added of the final product.

GVCs have been shown to be important channels for technology transfer across countries. The opportunities for transferring know-how, technology and process innovation through participation in GVCs are vast: firms can access new technology embedded in imported inputs and benefit from new varieties of intermediate goods by expanding the set of inputs.

2. GVC participation of Vietnam: Recent development

2. 1. Vietnam's global integration process

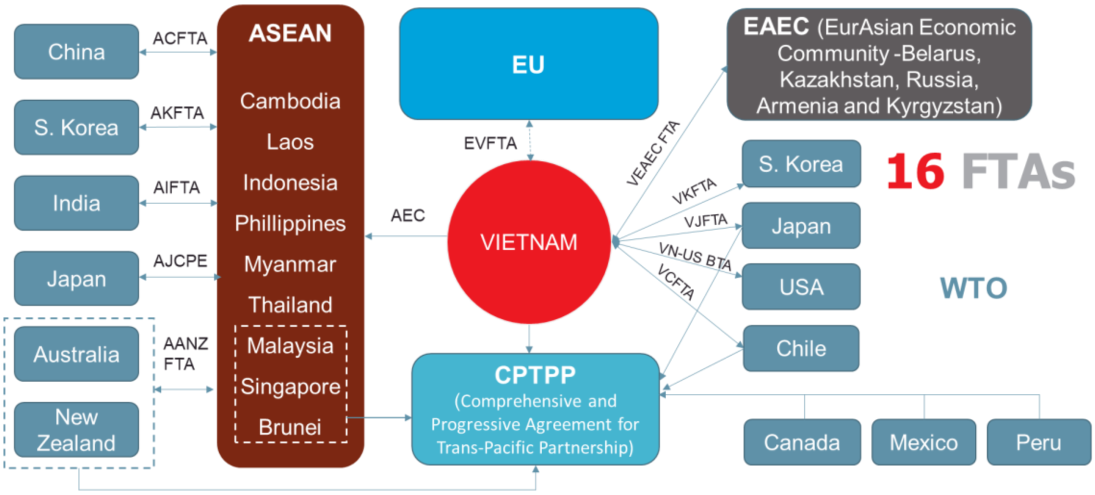
Since the 1986 launch of the economic reform under Doi Moi, Vietnam has transformed from one of the poorest nations in the world into a market-based economy. Vietnam has become more globally integrated, achieving the following milestones:

- On 28 July 1995, Vietnam joined ASEAN as seventh member
- On 11 January 2007, Vietnam became the 150th member of World Trade Organization (WTO)
- At the end of 2015, ASEAN Economic Community was established according to the agreement among ASEAN countries including Viet Nam

As of today, Vietnam signed 13 free trade agreements (FTAs) and is negotiating 3 FTAs (*please see Appendix 1 and the figure below for details*).

The access to ASEAN in 1995, to WTO in 2007 and several bilateral investment treaties and preferential trade agreements with, among others, ASEAN, China, European Union, Japan, South Korea, and the US etc. have helped Vietnam to attract an increasingly large amount of FDI. Vietnam has diversified its economic partners, through increased ASEAN integration, the proposed Regional Comprehensive Economic Partnership (RCEP) and most recently through the Comprehensive and Progress Agreement for Trans-Pacific Partnership (CPTTP) and the EU – Vietnam Free Trade Agreement (EVFTA).

Figure 2. Vietnam's Free Trade Agreements



Source: *Economica Vietnam (2020)*

For more than 30 years, Vietnam has gradually opened its economy from a closed economy to one of the most integrated economies in the world. As a result of its opening process, the trade openness ratio of Vietnam went over 210 percent of GDP in 2019 (WDI, 2020).

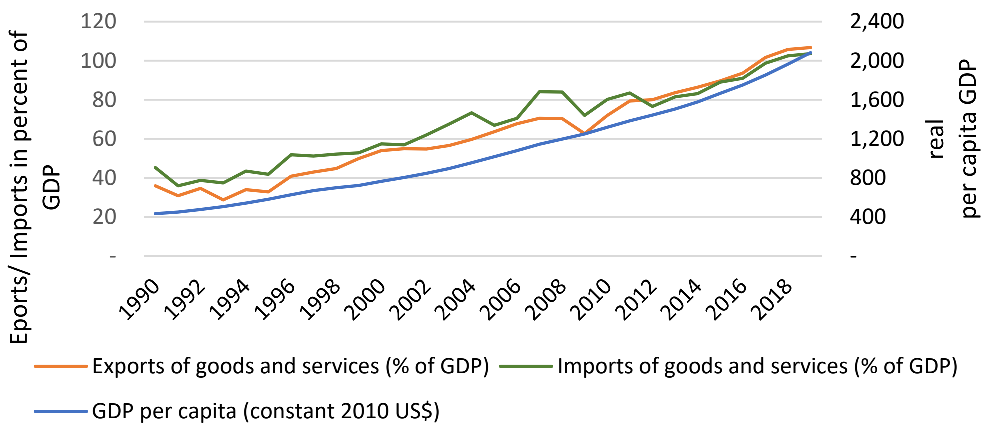
The poverty rate has been reduced remarkably along with economic development during this period, from 52.9 percent in the early 1990s to around 2.0 percent in 2019 (MOLISA, 2019). Figure 5 shows the level of exports to GDP, imports to GDP, and real per capita GDP ratio of Vietnam over nearly three decades. The export-led growth policy of the Vietnamese government has contributed to pushing up real per capita GDP nearly four times from US$ 433 in 1990 to US$ 2,082 in 2019 (figure 3). This achievement can be attributable significantly to trade liberalization underpinned by several free trade agreements (FTAs).

Vietnam has been transforming to an importing-exporting country. Since 2012, the share of exports to GDP has exceeded imports to GDP ratio (as shown in Figure 3). Vietnam is one of the most open economies to international trade in Asia. Vietnam's top exports are electronics equipment and goods, footwear, technology products, and automatic data processing machines. Key import goods include electronic integrated circuits and micro assembly tool machinery and petroleum oils. Based on the data on trade openness in 2019 of Vietnam General Statistics Office, the main trading partners are China, the USA, South Korea, ASEAN, the EU, Japan, Australia and India.

The Vietnamese economic model remains heavily dependent on foreign investment and exports, especially to ASEAN, China, Korea, Japan, EU, and the United States. The value of exports was estimated at USD 246.2 billion in 2019 and the imports of goods amounted to USD 253 billion in 2019; the trade surplus reached USD 11.2 billion in 2019 (GSO, 2020). According to the preliminary data from the Vietnamese government, manufacturing greatly contributed to expanding the trade balance, with the industrial trade surplus exceeding USD

10 billion for the first time in 2019. Moreover, Vietnam is a net importer of services, in 2018 the imports reached USD 18.2 billion, while exports amounted to USD 14.9 billion.

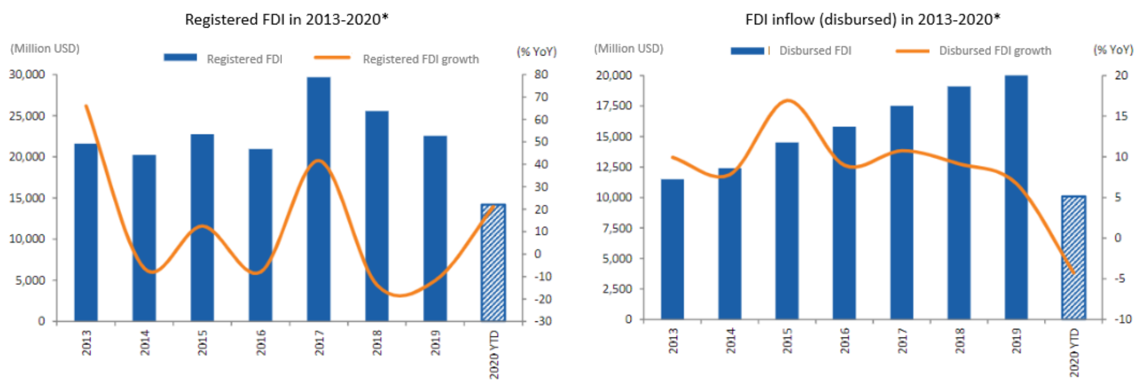
Figure 3. Exports/ Imports to GDP ratios & Real per capita GDP



Source: World Development Indicators (2019)

After more than three decades, the FDI inward stock in Vietnam had increased from less than $41 million to more than $145 billion (in 2018)[1]. The amount of annual registered FDI to Vietnam reached its peak in 2017 then decreased in 2019 (figure 4). However, in the first 7 months of 2020, the total newly and additionally registered capital of FDI was recorded at USD 14.2 billion, up 21.2% compared to the first 7 months of 2019. Total FDI inflow to Vietnam increased gradually over the period of 2013 to 2019 (figure 4). Regarding the FDI inflow situation in the first 7 months of 2020 , it was estimated at USD 10.1 billion, a decrease of 4.1% compared to the same period in 2019 (figure 4).

Figure 4. Vietnam's registered FDI & disbursed FDI amount



Source: Mirae Asset Securities (Vietnam) Research (2020)
**The number of 2020 is forecast*

The most attractive industries include manufacturing-processing industries, electricity production and distribution and real estate. Among the 120 nations and territories having

[1]UNCTAD, World Investment Report 2019, Annex Tables.

investment activities in Vietnam, in 2018, Japan, Korea and Singapore accounted for more than half of the total registered FDI. Despite the strong will and encouragement of pushing up investments in Vietnam, the capital from the US and the EU into Vietnam has so far not matched the potential (VCCI, 2020). Although the economy was strongly affected by the regional financial and monetary crisis in 1997 and the global financial crisis in the period of 2007-2008, Viet Nam has remained one of the fastest-growing economies in the Asia-Pacific region since the beginning of the 1990s. In 2019, its real GDP was more than $200 billion, more than eight times as great as in 1986[2].

Table 1. Investment flow (inward) to Vietnam, by activity over period 2014 -2018

Activity	2014	2015	2016	2017	2018
Primary Sector	244	283	205	1,468	207
Secondary sector	15,505	16,429	16,937	16,189	19,378
Tertiary Sector	6,173	7,403	9,749	19,444	16,784
Electricity, gas, air conditioning supply	228	2,799	310	8,374	1,817
Real estate activities	2,833	2,395	2,355	2,934	8,253
Wholesale and retail trade; repair of motor vehicles and motorcycles	405	684	1,972	2,193	1,728
Other service activities	2,707	1,524	5,111	5,942	4,985
Total	**21,922**	**24,115**	**26,890**	**37,101**	**36,369**

Source: Investment Map (2020)

FDI inflows to the secondary sector account for the largest proportion of the three sectors of the Vietnamese economy (except for 2017). In 2018, there were more than US $ 19,378 million FDI poured into the manufacturing sector, US $ 16,784 million was invested in in the service sector, and only about US $ 200 million invested in the primary sector. Real estate activities in 2018 attracted a huge amount of FDI, up more than 3 times compared to 2017, reaching about 8.3 billion USD (table 1).

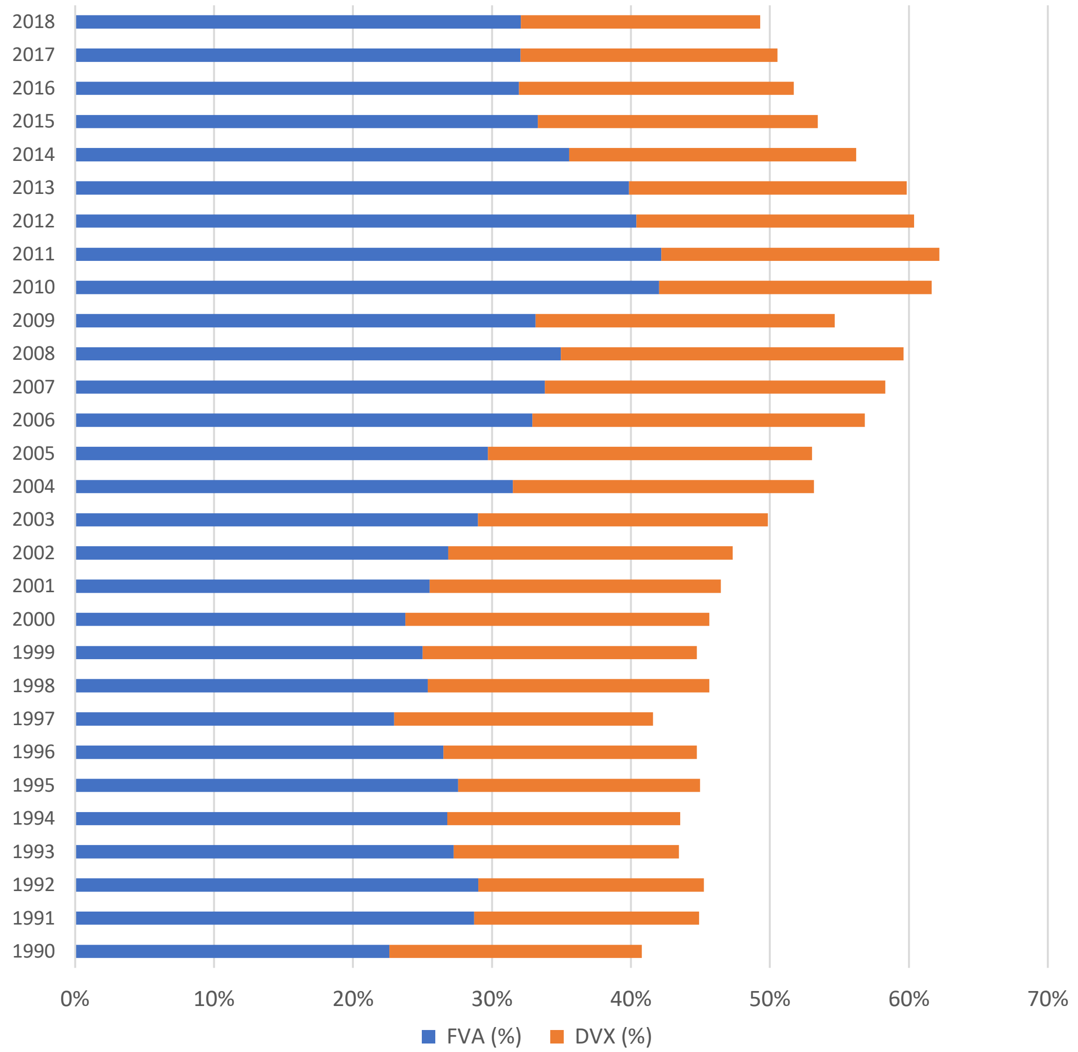
Along with an increased global integration development, the number of enterprises has risen strongly. However, most enterprises in Vietnam are currently micro, small, and medium enterprises (about 97% of total enterprises). According to the Ministry of Planning and Investment, as of December 31, 2019, there were 758,610 active enterprises. By economic sectors, 508,770 active enterprises are in the service sector accounting for about 67.1% of all enterprises, 239,755 enterprises in the industry-construction sector accounting for 31.6%, and 21,306 active enterprises in the sector of agricultural, forestry and fishery.

[2] World Bank Development Indicator 2020 (https://databank.worldbank.org/source/world-development-indicators)

2.2. The evolution of global value chain participation of Vietnam

GVC participation by Vietnam has mostly followed the upstream part, which has also been the dominant part since 1990 (ASEAN Promotion Centre on Trade, Investment and Tourism, 2020). The GVC participation index explains a country's involvement in GVCs from both upstream (by FVA) and downstream (by DVX). The higher the FVA share in gross exports and the higher the value of domestically produced intermediates to exports in third countries, the more integrated a country is in GVCs[3]. Over the last three decades, Vietnam has been active in both forward and backward participation. For example, the country imports raw materials, parts and component to process and export semi-finished goods and services for further processing or finished goods and services for consumption.

Figure 5. GVC participation in Vietnam, 1990 -2018 (per cent of total gross export)

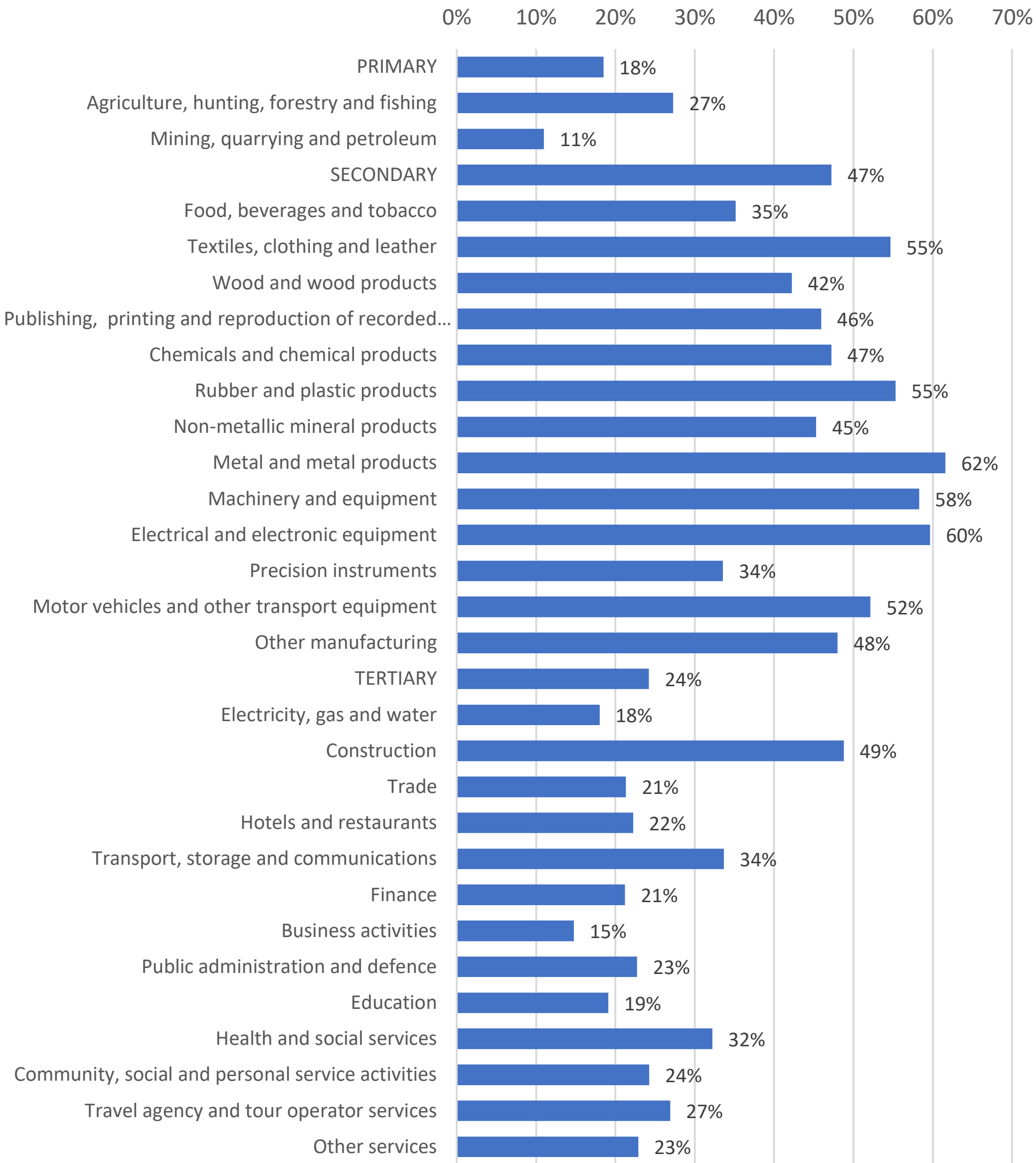


Source: UNCTAD-Eora Global Value Chain Database[4]

[3] De Backer, K and S. Miroudot (2013)
[4] Available at https://worldmrio.com/unctadgvc/

The GVC participation of Vietnam has fluctuated between 41 percent and 62 per cent since 1990 (Figure 5), mainly due to changes in the backward part. After reaching its peak of 62 per cent in 2011, the GVC participation rate has become lower, largely because of a lower FVA share as a result of more value added, created within Vietnam by both domestic firms and foreign-affiliated firms, with the latter being more prominent in producing high value added products.

Figure 6. Share of foreign value added in exports from Vietnam, by industry, 2017



Source: AJC-UNCTAD-Eora database on ASEAN GVCs

Investigating the participation in GVCs by industry in general shows that the secondary sector is the most globally integrated, followed by the primary and tertiary sectors. Specifically, textiles, clothing and leather, mining, quarrying and petroleum are equally important, as the top two contributors to the GVC participation index for Vietnam (figure 6). However, the situation is expected to change because of Vietnam's national development direction towards sustainability and its new focus on quality investment, not quantity.

First, in the long-term vision, Vietnam's exports would be less dependent on non-renewable resources such as minerals. Second, Vietnam has articulated its objective of attracting more FDI in high-tech industries instead of labor-intensive ones. Manufacturing; agriculture and fisheries, logistics; maintenance, repair, and overhaul; and tourism have been identified as priority industries. Third, increasing the participation of Vietnam in the global economy through FTAs, which are concluded among the largest ASEAN member states, facilitates trade between Vietnam and international trade partners. Vietnam has aimed to raise the significance of the domestic sector in gross exports, in terms of creating more added value and more exports for the final demand. These initiatives have been changing GVC participation in Vietnam; consequently, a downward trend has been witnessed in shares of FVA and DVX but not in DVA.

In Viet Nam, the foreign content of secondary sector (manufacturing) is the highest among the three sectors, it is also the most GVC-involved sector (figure 6). In 2017, the share of FVA in exports of the manufacturing sector was 47 per cent, nearly double that of the service sector (24 per cent) and approximately triple that of primary sector (18 per cent). Primary sector had lowest FVA in exports among the three sectors in 2017, in which agriculture, hunting, forestry and fishing are the key industries in exports, have highly developed value chains with the share of foreign value added in exports at 27 per cent (figure 3). In the service sector, the construction industry has the highest rate of foreign value added (49 per cent); transportation, storage and communication industry has second-highest rate of foreign value added (34 per cent)

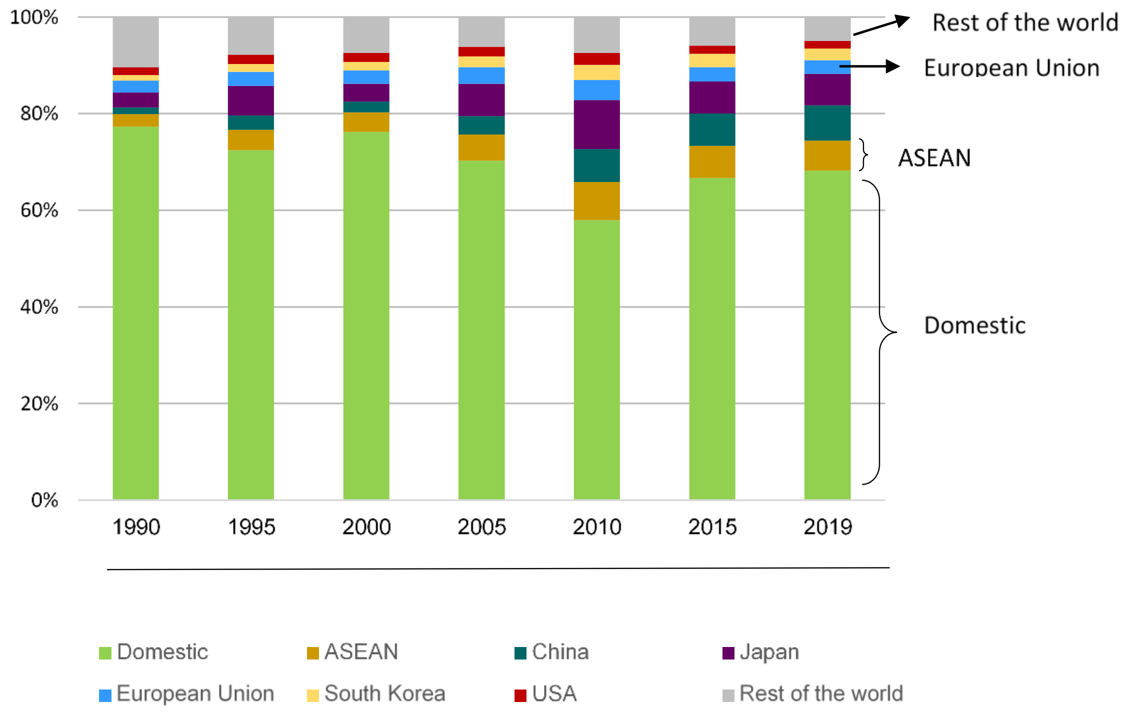
Figure 6 shows that most of the main industries for export (such as electrical and electronic equipment; rubber and plastic; wood and wooden products; and textiles, clothing and leather) are those with higher level of GVC participation. This statistic is compatible with the trend of the preferred type of FDI flow in Viet Nam in manufacturing sector (please see more in table 1).

ASEAN member countries, China, Japan, the EU, the Republic of Korea and the USA had become more important contributors to Viet Nam's value added exports, while Japan continued to occupy critically important positions in Vietnam's GVCs (figure 7).

Although inputs from China fluctuated between 1990 and 2000, the Chinese share rose dramatically as time passed, becoming the largest in 2015. Japan and ASEAN have always played important roles in adding value to exports from Vietnam. Their shares started as the largest ones in 1990 at 3 per cent each, then reached a peak in 2010 of 10 per cent and 8 per cent, respectively, before declining in 2019 to 6-7 per cent each. Korean inputs grew gradually from 1 per cent in 1990 and reached a peak of more than 3 per cent in 2010. Similarly, the

European Union's input rose from 2.5% in 1990 and reached a peak of 4.2% in 2010, and then reduced to a stable level of 2.8% in 2019. In contrast to the general trend in ASEAN in which the importance of United States has been declining, the contribution of the United States to value added exports from Vietnam has remained stable at 2 per cent over the past three decades.

Figure 7. Value added exports from Viet Nam, by domestic, ASEAN and top four non-ASEAN foreign value-added creators, 1990–2019 (Per cent of total gross exports)



Source: AJC-UNCTA-Eora database on ASEAN GVCs.

2.3. Impact of FDI on GVC participation of Vietnam: Backward linkage of Vietnamese industries

FDI often follows trade. In reality, the country has become increasingly accessible to foreign investments. As of the end of 2019, the whole country counts 30,827 FDI projects with a total registered capital of US$362.58 billion. Of the amount, $211.78 billion or 58.4% of total registered capital have been disbursed. Manufacturing and processing remain the favorite sectors for foreign investors, reaching US$16.5 billion in 2018, accounting for 46.8% of the total FDI. Real estate moved up to 2nd place and reached US$6.6 billion, or 18.7%. Wholesale and retail trade; repair of motor vehicles and motorcycles secured the 3rd position at US$3.6 billion, accounting for 10.4% (PWC, 2019).

As of December 2019, FDI has been present in all 63 provinces and cities of the country, in which Ho Chi Minh City continued to rank first in FDI attraction with 47.34 billion USD (making up nearly 13.1% of the total investment capital), followed by Binh Duong with 34.4 billion USD (accounting for 9.5% of total investment capital), Hanoi with 34.1 billion USD (capturing 9.4% of total investment capital)[5].

In particular, in 2019, the EU had 2,375 investment projects from 27 European countries into Vietnam with a total registered capital of US $ 25.49 billion accounted for 7.70% of Vietnam's projects. EU investors are also busy investing in infrastructure projects such as Vinci Construction (France) selected to improve drinking water supply to Ho Chi Minh City. A consortium led by Alstom (France) with Colas Rail (United Kingdom) and Thales (France) won a metro system contract to be completed by 2021. T&T Group and Bouygues S.A. signed a contract worth 250 million Euro to re-build Hang Day Stadium, for an investment opportunity in the 31st SEA Games, which will take place in Vietnam in 2021[6].

The effect of FDI depend on the value-added structure of Vietnamese economy, in which the secondary sector (manufacturing) – in particular, food products, beverages and tobacco – exhibits a larger multiplier effect. In the industry structure of Vietnam, manufacturing takes the lead in output, followed closely by services. The input-output table reported by the Organization for Economic Cooperation and Development (OECD) shows that the manufacturing sector accounted for 50 per cent of industry output in 2015 (the most recent data available), followed by the service sector with 32 per cent and the primary sector with 19 per cent. Regarding value added, the contribution of the services sector is dominant at 45 per cent in comparison to 33 per cent from the primary sector and 22 per cent from manufacturing[7].

The situation of the manufacturing sector, at the lowest value added with the highest output, demonstrates the urgent requirement for policymakers to think about how to leverage the productivity level in this sector. Improvements in productivity in this sector come from the following critical factors: technological development and innovation; infrastructure development; increases in the contribution and production capacities of micro, small, and medium sized enterprises (MSMEs); greater focus of FDI into prioritized industries; and involvement in and upgrading within GVCs.

Vietnam's electronics sector has expanded dramatically in less than a decade; Vietnam is the second-biggest exporter in the world after China, producing 40 percent of Samsung's global mobile phone products and employing 35 percent of its global staff. As a result, Vietnam has become one of the main manufacturing hubs in Asia for mobile phones. Vietnam's success can be attributed to a combination of factors. Trade liberalization—driven by World Trade Organization (WTO) accession and an agreement with the United States, a favorable investment climate, and a large pool of low-cost labor has determined Vietnam's

[5] MPI brief report on foreign direct investment
http://www.mpi.gov.vn/en/Pages/tinbai.aspx?idTin=45020&idcm=122

[6] Doing business in Vietnam 2019. PWC (2019)

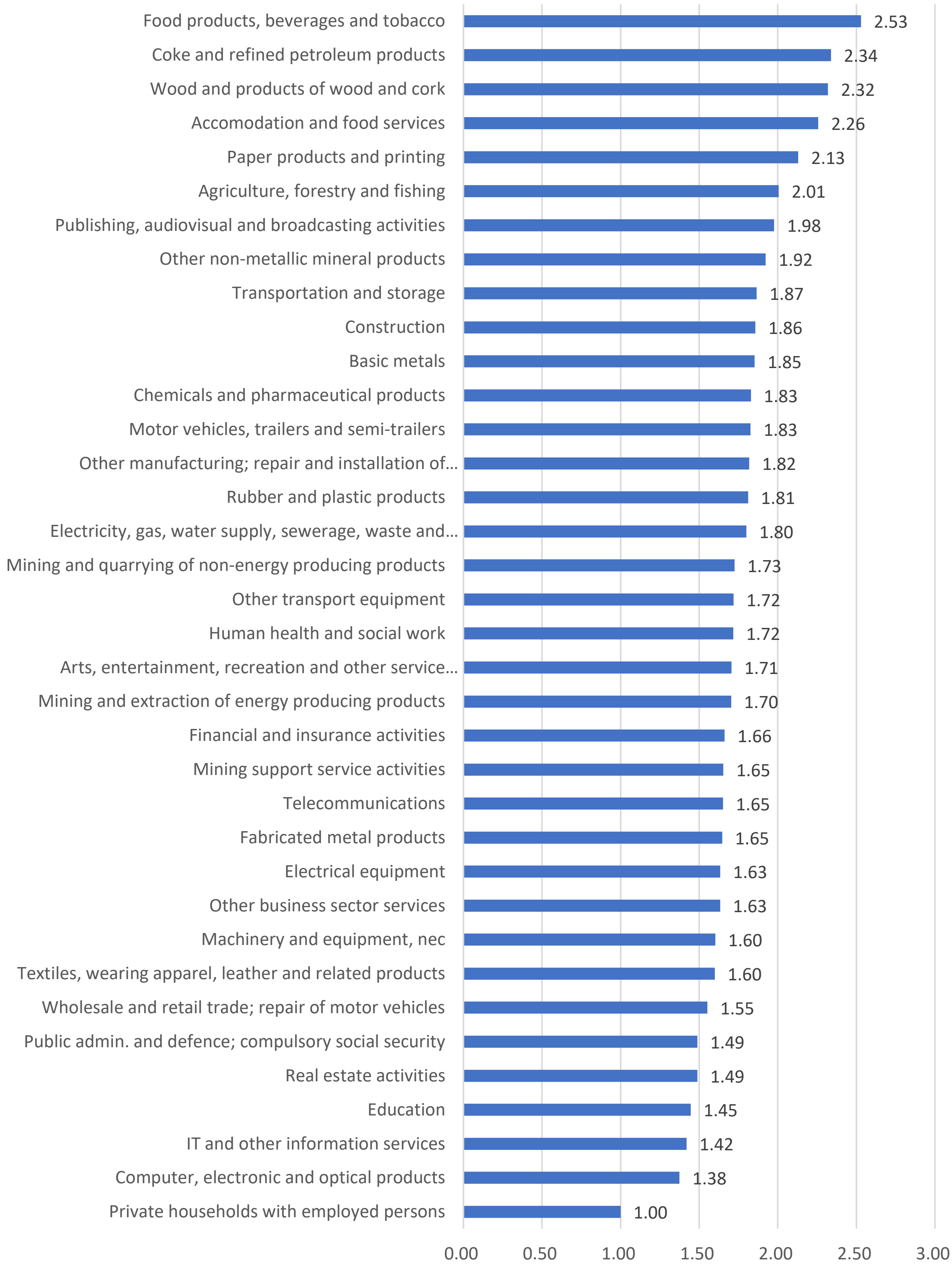
[7] OECD Input-Output Table (www.stats.oecd.org).

attractiveness as a global value chain (GVC) location. The result was foreign direct investment (FDI) inflows, including those from Samsung. Vietnam's geographical proximity to regional suppliers of electronics parts and components such as China, Japan, the Republic of Korea, and Thailand helped foreign investors gain access to high-quality inputs from abroad. And improved connectivity enabled Vietnam to import and export in a timely manner.

Vietnamese enterprises can participate in any value chain created by foreign transnational corporations (TNCs). It is strategically important to be involved in those industries that have large linkage or multiplier effects. Two industries of those having multiplier effects greater than two (i.e. one unit of output in a particular industry leads to a total of increase in the economy of more than two units): food products, beverages and tobacco, and wood and products of wood and cork (figure 8). In general, the manufacturing sector dominates the top positions in the multiplier effects table. This implies that it can have larger impacts on other industries through their activities (i.e. investment) than other sectors. That can also be explained by the fact that value chains in the manufacturing sector are longer and broader than those in the primary and service sectors.

Involvement in GVCs should be easier to establish in manufacturing as a manufacturer can be involved in different supply chains and each supply chain can be built with both multi-tier suppliers (upstream) and multi-tier clients (downstream) before reaching the end-users. Each industry has its own characteristics and unique involvement in GVCs; therefore, the development of an industry can affect an economy through the multiplier (backward linkage) effects of that industry. In other words, generally speaking, in an entire production chain, the industry having more connections can create greater impacts. Thus, resources-based manufacturing industries show higher multiplier effects than does production in the primary sector (e.g. 2.01 for the primary production industries of agriculture, hunting, forestry and fishing in comparison with 2.53 for food products, beverages and tobacco or 2.33 for wood, products of wood and cork, both secondary manufacturing industries connected to primary resources (AJC, 2020)).

Figure 8. Backward linkage of Viet Nam industries in 2015[8]



Source: OECD Input-Output Table (www.stats.oecd.org).

[8] Figure 9 shows increases in the whole economy due to one unit increase in output of each industry.

In participating in the global value chains, Vietnamese enterprises only take part in simple stages such as processing, assembling stages with low value-added with limited sustainability for the future. In its annual Provincial Competitiveness Index (PCI) survey, the Vietnam Chamber of Commerce Industry (VCCI) shows that most Vietnamese private enterprises sell products and services to domestic private companies. Only 15% of private domestic enterprises sell products and services to foreign private enterprises in Vietnam. Also, 8.4% of private domestic enterprises export directly and 7.4% export indirectly through selling to third-party purchasing partners.

The average share of local sourcing by foreign MNEs in Vietnam is at 45%, lower than all main ASEAN competitors (Thailand, Indonesia, Malaysia, the Philippines). According to a JETRO survey, 17 Japanese firms, one of the largest foreign investors in Vietnam, sourced 32.4% of inputs from local suppliers in 2016. This is much lower than their peers in neighboring countries, e.g., the People's Republic of China (PRC) (67.8%), Thailand (57.1%), and Indonesia (40.5%). It should also be highlighted that of the firms that supplied to Japanese FDI companies in Vietnam, 58.9% are FDI companies that are based in Vietnam. Only 13% of local inputs were supplied by Vietnamese-owned firms.

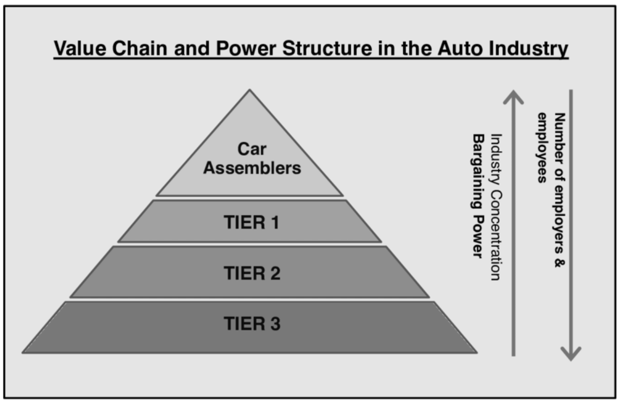
In the case of Samsung in Vietnam, though the company said that the localization rate of Samsung mobile is 57%, only 29 Vietnamese-owned companies were supplying directly to Samsung by the end of 2016. Most of the localized inputs sourced locally as disclosed by Samsung are from other foreign investment enterprises (most of them Korean-invested companies). In another case, the localization rate of Canon Vietnam is 60% but this is mostly thanks to the purchase of FIEs which are based in Vietnam. Canon has more than 140 suppliers to its factory in Vietnam and 20 out of them are Vietnamese enterprises.

Piaggio Vietnam, an assembler of the scooters, motorcycles, said that they have localization rate of 89% for Vespa and 84% for Piaggio Liberty with 98 domestic suppliers and 78 foreign suppliers[9]. The rates of Piaggio Vietnam are higher when compared with other manufactures working on the similar ranges of products. More than half of products of Piaggio Vietnam have been exported to major market in Southeast Asia and Asia Pacific, a small number of motorcycles are exported to the EU and the US. Most of the domestic suppliers are foreign-invested enterprises which are based in Vietnam and, as of today, Vietnamese suppliers mostly provide simple inputs like palette, packaging, plastic inputs[10]. This suggests that European companies tend to enter into closer and deeper partnerships with its Vietnamese suppliers in their GVC.

[9] Piaggio Vietnam confirms the Vietbrand, http://baovinhphuc.com.vn/en/business/19290/piaggio-vietnam-confirms-the-vietbrand.html

[10] "Supporting Vietnamese Enterprises to Develop Sustainable Value Chains", MPI Workshop on 24 July 2020.

Figure 9. Tier hierarchy of automotive Industry



Source: Heras, Jon. (2015)

In global commodity chain model, the power relation between a lead firm and a set of multiple subcontractors that operate at different tiers along production chains are considered (Gereffi and Korzeniewicz 1994). A tier one (first tier) company is the most important member of a supply chain, supplying components directly to the original manufacturer that set up the chain (figure 9[11]). Creating a tiered supply chain is part of supply chain management. In the automobile industry where 20 large automobile assemblers are operating, there are only 81 tier-1 suppliers and 145 tier-2 and tier three suppliers. Meanwhile, in Thailand, there are 16 large automobile assemblers, but the country has 690 tier-1 suppliers and 1700 tier-2 and tier-3 suppliers (World Bank, 2016).

Vietnam has increased the backward linkages, that is, the use of imported goods and services in its production of exports. Vietnam has primarily participated at the production and assembly stage of the manufacturing sector (light manufacturing, electrical equipment, electronics etc.) in the GVCs. Vietnam's DVA share in gross exports fell from 77% to 68% during the period of 1990-2019 (AJC, 2020). Vietnam has been able to shift a significant proportion of workers from the relatively less productive agricultural sector to the more productive manufacturing and services sectors.

2.4. Policies/ programs to support Vietnam's integration into GVCs

The government issued the Decision No. 879/QD-TTg to approve the Industrial Development Strategy through 2025 with vision toward 2035 with the following objectives: (1) to effectively mobilize all resources from domestic economic sectors and external resources to develop and restructure the industrial sector towards modernity; (2) to focus on training skilled, disciplined and innovative workforce for the industrial sector; (3) to prioritize the development and transfer of technologies in the industrial sub-sectors and fields with competitive advantages and modern and advanced technologies such as agricultural, forestry and fishery product processing, electronics, telecommunications, new and renewable energy, mechanical engineering, and pharmaceutical chemistry; (4) to rearrange the allocation of

[11] Heras, Jon. (2015). Framing Labour Strategies in the European Automotive Industry: Any Inflexion Point Ahoy?. Wirtschaft Und Management. 22. 95-111.

industrial space to promote the combined strength of sub-sectors, regions, and localities for deep participation into the global value chain.

The Government has recently stepped up efforts to improve trading across border procedures. In September 2015, Vietnam became the fifth ASEAN Member State to join the ASEAN Single Window, following Singapore, Indonesia, Malaysia, and Thailand. Efforts are being made in order to make the single window to become even more helpful for businesses. According to Decision No. 1245/QĐ-CP by the Government, 263 customs-related procedures will be introduced in NSW. Between 2017-2019, 12,600 categories of goods are taken out of the list which is required to be subject to specialized inspection. The Government also aims at reducing the number of goods which are subject to specialized inspection by 50% by the end of 2020[12.]

Ministry of Industry and Trade (MOIT) and some MNEs have organized a number of sourcing fairs. Most prominent of all, the Ministry cooperates with Samsung in organizing Samsung Sourcing Fairs in which Samsung met with Vietnamese SMEs, sharing their sourcing strategy and plans, and working with eligible Vietnamese SMEs to be upgraded to be suppliers (tier 1 or tier 2) of the MNEs. Such fairs are important to address the information asymmetry barriers. However, the number of such fairs are limited. Few other MNEs have replicated such efforts. MOIT is yet to announce a plan or strategy to replicate such efforts with other FIEs or MNEs in Vietnam.

The Government has implemented a plan to develop supporting industries[13]. The most recent program to support supporting industries includes mostly tax incentives and focuses on five main sectors: textile and garment; footwear and leather; electronics; automobile; machine tools; and high-tech industry. There are, nonetheless, some problems in the implementation of this program. First, budget resources dedicated to the program are relatively small and mostly limited to corporate tax incentives and subsidized and/or guaranteed loans. However, other relevant policies in the context of supporting industries such as skills upgrading initiatives or cluster development are not part of this policy. Second, the definition of supporting industries appears to be too rigid and highly skewed towards manufacturing, whereas the services sector can also perform an important “supporting” function towards exporting industries. Third, there is also room for improvement in the monitoring and evaluation of the SI policy because, although there are targets indicated in terms of beneficiaries, it is not clear how they have been chosen, if they are too unrealistic or are rather too easily achievable. Finally, the existing incentives of the policy could also be extended to second-tier suppliers, to build more locally integrated value chains.

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[12] In 2019, 82,698 goods are subject to specialized inspection as required by laws (Vietnam Customs, 2019).

[13] *The term “supporting industries” is used by the Government to define industries manufacturing materials, accessories, components, and spare parts used for assembling finished goods.*

The government has been fostering the FDI-SME linkages via different means, one of which is tax incentives. The maximum number of years for full corporate income exemptions (or tax holidays) in Vietnam is four years, the lowest in ASEAN, in comparison with 20 years as the highest in Indonesia (OECD, 2019). More advanced ASEAN countries such as Singapore and Malaysia have specific tax incentives to promote investment in local SMEs and upgrading of local suppliers. Vietnam may consider further expansion and new tools on tax incentives to level itself with regional peers' competitiveness.

Vietnam has set up a regulatory framework to encourage the development of linkages between SMEs and foreign enterprises. This is part of the country's initiative to integrate local enterprises into GVCs. The Prime Minister's Decision No. 1556/QD-TTg mandated the government to assist SMEs engaged in ancillary industries to participate in the production networks of MNCs. Moreover, the Prime Minister's Decision No. 32/2012/CT-TTg encourage the removal of barriers and an improvement in foreign investment policies and the call for the development of a scheme prioritizing the development of enterprises with high competitive advantages over the 2013-2020 period.

The Vietnam Supporting Industry Association (VASI) is an active player in promoting linkage between SME and MNE and GVCs through both linkage events and policy advocacy work. MPI is also active through the LinkSME Project with support by USAID. MPI is in the process of formulating a Five-Year SME Development Plan with focus on Business Startups and SME Linkage with GVCs.

3. Opportunities and challenges for Vietnam integrating into GVCs

3.1. Opportunities, drivers and enablers

Vietnam's consistent policy of openness and export-led growth has paid off. Economic reforms undertaken since the 1990s and culminating in its 2007 accession to the World Trade Organization (WTO) enabled the country to follow the path of other East Asian economies and to leverage trade and FDI for economic growth and poverty reduction. Trade developed on the backbone of GVCs, allowing Vietnam to grow domestic value-added through exports. Vietnam has shown higher integration in GVCs as a buyer and seller since 1995.

Vietnam's trade has grown alongside its deepening global integration and participation in global value chains. The revolution in Information and Communication Technologies (ICT) and falling transportation and communications costs drove offshoring and unbundling of production from the developed to the developing world and gave rise to global value chains. This has implications for (a) how developing countries can participate in international trade—joining GVCs by "importing to export," and (b) how trade can be a vehicle for development—enabling knowledge dissemination along with jobs in multinational corporations (MNC) production. Since 1995, Vietnam has carved out a role for itself within GVCs, showing higher integration as a buyer and a seller in GVCs. An improved business environment for attracting qualified foreign direct investments (FDI) has promoted Vietnam's participation in a number of GVCs. Between 1995 and 2011, Vietnam grew its domestic value-added embodied in its gross export by 16.6 percent annually, just below that of what China had achieved. By specializing in assembly functions on behalf of primarily foreign firms, Vietnam's export-oriented development strategy has created jobs, propelled economic growth, and reduced poverty.

Participation in GVCs has been driven largely by foreign-owned firms. While domestic private firms in Vietnam are predominantly small and medium-sized enterprises (SMEs accounting for about 97% of total Vietnamese enterprises), most of the revenue for a number of crucial exports came from the FDI sector. In the telephones and components category, the FDI sector accounted for 95% of the total export value. The domestic economic sector earned more than US$82.9 billion, accounting for only 31% of the total export turnover in 2019 (GSO, 2019).

Vietnam has adhered to deep trade agreements with different economies, for example the EU, the United States, ASEAN, Japan, China and Korea. The CP-TPP and EVFTA, which are considered to be new generation trade agreements, are comprehensive in scope and strong in commitments that it is almost impossible to identify at first sight the positive and negative implications. Many studies project positive effects of PTAs for Vietnam 's GVC participation in general, indicate that this will occur mainly in low-skilled labor segments, where Vietnam already has a comparative advantage (Hollweg, Claire H. et al., 2017).

Vietnam may also benefit from changing global supply chains due to the recent trade tension between China and the United States. The war has changed the GVCs of multinational companies, especially MNCs having manufactures in China. The relocation of multinational companies' production out of China to avoid U.S. tariffs on Chinese goods has created opportunities for other countries to participate in global supply chains. Opportunities from new FDI inflows due to the relocation of factories from China to other countries may prompt Vietnam to change policies to attract high-quality FDI inflows. Vietnam can also benefit from this shift by joining GVCs in high-technology industries.

The promotion of FDI is the main strategy of the Vietnamese government in some main sectors, especially the electronics sector. Partly due to tax incentives and preferential access to land, in recent years the electronics sector experienced increased FDI inflows of high-tech electronics companies such as Canon, Intel, Samsung, and LG etc.

Given the immediate opportunities presented by trade preferences, it makes economic sense to prioritize product and process optimization as a first step before proceeding to functional upgrades. In doing so, Vietnam's advantages in low labor costs, access to backward linkages, and preferential trade agreements (for some) should be leveraged to maximize gains. The Vietnamese economy currently is highly competitive in relatively low-skilled, labor-intensive tasks, history has shown that wages eventually will rise and this comparative advantage will erode. In reality, Vietnam is gradually losing its "labor dividend" advantage. To avoid the middle-income trap, deeper integration into GVCs will be helpful for Vietnam.

Servicification of the domestic economy will release opportunities at three levels. It can accelerate productivity-led growth and competitiveness in the economy at large as an input to downstream activities; it can be a skill generator of domestic capabilities and high value-added jobs in core segments and connected upstream and downstream activities; and it would also have the potential to enable Vietnam to become a leading global or regional player in services exports (World Bank, 2017). Policy can play an important role in driving and enabling *servicification* of the domestic economy. Today, binding constraints include regulatory and other horizontal issues such as workforce skills. Promoting trade and investment in services through active policies include reducing regulatory restrictions and improving global trade networks through a regional trade agreement.

Selected Sectors in Vietnam and Linkage with GVCs

The future of the *Vietnamese textile and apparel industry* will be supported by:

- Cost competitiveness (labor, electricity rates) and productivity.
- A supportive industrial environment. Vietnam's investment incentives and tariffs are competitive with other apparel producing countries.
- Trade preferences.
- Access to foreign markets (via MNCs).
- Connection (through trade and investment) and proximity to China.
- Product diversity and footprint in man-made fiber (synthetic) apparel

The future of *Vietnamese agribusiness* will be driven by demographic changes, agricultural restructuring efforts, the future of regional and global trade, and the governance of lead firms in GVCs.

Vietnam's *ICT sector* has expanded dramatically in the last few years with large investments from lead firms (such as Samsung and LG), contract manufacturers (Foxconn and Jabil Circuit), and platform leaders (Intel and Microsoft). These firms' investments—made largely due to Vietnam's low cost of labor, proximity to regional suppliers, and relatively stable investment climate—have helped transform the country's industrial landscape in a very short period. Notebook computers, mobile phones, software, and ICT-enabled services are now among Vietnam's most important exports.

Source: *Vietnam at a Crossroads, WB (2017)*

3.2. Challenges, barriers, and threats

The rate of growth in labor productivity (output per worker) has been declining since the late 1990s, explained by a sharp decline in total factor productivity growth. Domestic private firms are overwhelmingly small, which prevents productivity gains from scale economies, specialization, and innovation—ingredients for sustained long-term growth. Moreover, small firms have become increasingly capital intensive, which without scale economies has led to a sharp decline in their capital productivity. The few large domestic firms are even more unproductive than the smaller ones. This reflects their short-term view on investment and profits and their rising concentration of land and capital assets in construction, real estate, and banking and finance, for example. Such sectors show some of the country's lowest levels and growth rates of productivity.

Information asymmetry is one of the biggest constraints faced by domestic enterprises when integrating into the GVCs and in linking up with FIEs and MNEs. Most Vietnamese enterprises lack awareness about free trade agreements (FTAs). For example, at the national level, according to recent data from the Provincial Competitiveness Index Report, only 1.55% of Vietnamese enterprises surveyed had in-depth knowledge of the EVFTA while more than 65% of enterprises had only heard of it briefly. Vietnamese enterprises also lack information and knowledge about non-tariff measures and ways to tackle these barriers to trade. Information barriers also make it difficult for many domestic enterprises to identify foreign business opportunities, especially in markets that are far from Vietnam, and where information in English is limited. Limited information prevents them from analyzing the market and locating them properly. They often lack information on MNEs, FIEs, and their demand for outsourcing, their sourcing strategies, and standards. On the side of MNE and FIEs, they lack information on domestic SME suppliers and their capacity. To date, there has not been a well-functioning data in which domestic enterprises can find information and opportunities to supply to FIEs and MNEs. The MOIT has recently introduced an online platform to support the linkage. However, the database is still limited and is still in the making. At the provincial level, such databases are being set-up but are yet to be open up for the use of businesses. For example, the Department of Planning and Investment in Ho Chi Minh City is setting up a database of potential SME suppliers for MNEs and SMEs, but the database is paper-based.

Limitations in human resources at both leadership, management and skill level is a major barrier. Lack of qualified managerial staff, engineers, and high-skilled workers and weakness in soft skills and communication capacity of staff exacerbate the problem when businesses make efforts to participate in GVCs. First and foremost, this results in a lack of confidence among Vietnamese enterprises when dealing with FIEs or MNEs[14]. In addition, the constraints in human resources has resulted in a poor managerial capacity, inability to communicate with potential customers in overseas markets as well as in navigating the procedures required by both customs authorities in Vietnam and import countries. In addition to this, lack of well-trained and skilled workers continue to constrain their investment, though domestic businesses are investing increasingly in high-tech technology, machinery, and production techniques to meet with international and export market requirements. Due to human resource constraints, labor productivity in the woodwork industry in Vietnam is equal to only 50% of that in the Philippines, 40% of that in China, and 20% of that in the EU. Domestic enterprises are focused on vertically integrating within Vietnam and selling to the local market

[14] "Supporting Vietnamese Enterprises to Develop Sustainable Value Chains", MPI Workshop on 24 July 2020.

rather than understanding how the GVC works and identifying ways to become more engaged internationally.

Few companies have a clear vision and strategy on how to become international vendors which enables them to be upgraded higher in the international value chains. FIEs and MNEs seek suppliers that could meet such standards as quality, technology, costs, feedback, and reliability. Apart from these, international companies also expect a strong business culture that can be cultivated only by qualified human resources. Such business culture is built on trustworthiness, reliability, respect, mutual care, teamwork, co-operation, and regular communication. These dimensions are also important for transnational businesses when seeking suppliers. Most notably, lack of management tools such as a standard quality-control system, and problem-solving skills leads to low reliability in delivering products in the standards, quality, and time as required by MNEs. Many domestic enterprises lack knowledge of how GVCs works regionally and globally. They have little knowledge of the players in the GVCs. It is important that SMEs be cognizant of how buyers and MNCs interact in the GVC.

The lack of capital accumulation is a critical issue. Constraint in capital accumulation has hindered the capability of Vietnamese enterprises to contribute to the move from factor-driven to efficiency-driven, or from labor-intensive to capital-driven economic models. Lack of adequate capital has also prevented private companies from investing in and upgrading their technology" (Economica Vietnam, 2018). This, on its turn, will affect badly the firm-level productivity and the sophistication of companies – an important factor for Vietnamese enterprise integration in the global value chain. Access to finance is important for supporting industries to develop, but also for the domestic economic sector to move into higher value-added activities. For firms to move from simple to sophisticated production, from CMT to FOB or ODM involves sourcing materials and other inputs themselves, requiring the firm to be in a much stronger financial position, with access to its own liquidity or external loans. Most Vietnamese enterprises are facing constraints in trade finance. Practice shows that the availability of finance is essential for a healthy trading system. Globally, up to 80 percent of global trade is supported by some sort of financing or credit insurance. This percentage is incredibly low in Vietnam. There are significant gaps in provision and therefore many companies cannot access the financial tools that they need. Vietnam's sovereign rating is lower compared to regional peers like the Philippines or Thailand. Given the relatively lower rating, international banks may not have adequate country limit/counterparty limit to take Vietnamese banks or corporate risk. Vietnamese enterprises rely on local banks to meet their financing needs. But too often these businesses cannot obtain the credit they need to meet their pre-export and import financing needs. This prevents local enterprises from reaching their full potential.

At the firm level, very few domestic firms have international standard certifications. Due to limited technology adoption, domestic businesses in the last few decades are involved mostly in low value-added assembling activities. The number of local businesses joining the supply chain of FDI firms remains limited, especially in an industry which requires higher technology such as in automobile and electronics. Therefore, a key challenge is to upgrade the domestic firms' production capabilities in order to participate in higher value-added activities. In reality, it is not a simple task for Vietnamese businesses, especially small and medium-sized enterprises (SMEs), to meet the standards and requirements necessary to join the global supply chain of foreign firms. Vietnamese SMEs still lack management tools such as a standard quality-control system and problem-solving skills. Most small enterprises have revealed shortcomings in meeting international safety standards despite buyers showing a keen interest in firms that can adhere to these standards.

Vietnam is far from an innovation-led and technology-driven economy, and its performance in terms of innovation is unsatisfactory. There is a limited number of private-sector research and development institutions in Vietnam. According to the Ministry of Science and Technology, there are only about 3,000 companies accredited as science and technology enterprises. Infrastructure and funding for research and development are generally poor quality. STEM and innovation curriculums remain underdeveloped. Access to advanced technologies, including information and communication technology, in agribusiness, manufacturing, and services are yet to be fully exploited. The enforcement of intellectual property laws and regulations is ineffective, resulting in rampant violation of intellectual properties, trademark, and copyrights. This dampens the interest and the desire of the people in general and of private sector businesses in particular, to innovate.

*There is a low level of technological transfer from Multinational Enterprises (MNEs) to SMEs***.** Low technology and limited investment in technology upgrading and R&D prevent SMEs from upgrading to meet the standards and requirements set by MNEs or to absorb the technology, knowledge, expertise transferred by MNEs. This, on its turn, discourages MNEs from actively seeking business cooperation with local SME suppliers in Vietnam. Therefore, exports and supplies by Vietnamese enterprises to GVCs are still largely concentrated in low technology and low-value-added industries, with competitiveness based on cost rather than quality. Due to the weak link between SMEs and FIEs, technology transfer is limited, failing to raise the productivity of domestic enterprises. The information gap exists between potential technology users and the owners of technology and intellectual property across the globe. Technology providers might be unable or unwilling to take the costs and risks involved in adapting technology into Vietnam. These include costs associated with both regulatory adaptations and technical adaptations to meet affordability requirements.

Business environment constraints and some specific framework conditions also affect the ability of local businesses to participate in or move up the value chain: e.g. unfriendly regulations on paying taxes and trading across borders, weak enforcement of the Intellectual Property Rights (IPR) law, slow and costly customs procedures clearance, etc. In a survey on the perception of business on customs procedures in 2019, 20% of businesses found it extremely difficult. They also found it difficult in customs clearance procedures and 23% said the tax refund payment in import and export tax is overly complicated. 25% of businesses in the survey disclosed that they completed customs procedures online but are still required to submit hard copies to the customs office.

*Transportation and connectivity are still less developed in comparison with the potential of integration into GVCs***.** A country's ability to connect to global markets for goods, services, capital, and people is a key driver of its international competitiveness. According to the 2018

Logistics Performance Index, by the World Bank (WB), Vietnam is ranked 39 of 160 countries in LPI (logistics performance index). Logistics and trade facilitation are limited by the poor efficiency of customs clearance, weak infrastructure quality, and the quality and competence of service providers. Connections to international trade networks are good but are less strong than in neighboring countries, limiting regional competition. Logistics costs are excessively high for Vietnamese businesses, especially for SMEs. Despite a railway across the country from north to south, cargo volumes transported by rail are small and have fallen largely due to poor service.

4. EU trade and investment and its contribution to Vietnam integrating into GVCs

The EU has been a main factor in the relationship between Vietnam and Europe for a long time. The trade relations of Vietnam – EU have developed rapidly since 2000 with the total trade balance of Vietnam – EU has increased more than 13.7 times, from US$ 4.1 billion in 2000 to US$ 56.45 billion in 2019; in which, exports from Vietnam to the EU has risen 14.8 times (from US$ 2.8 billion to US$ 41.54 billion); and imports from the EU to Vietnam has risen more than 11.4 times (from US$ 1.3 billion to US$ 14.9 billion). In 2019, total exports and imports between Vietnam and the EU reached over US$ 56.45 billion, increasing by 1.21% compared with the same period of 2018 (table 2).

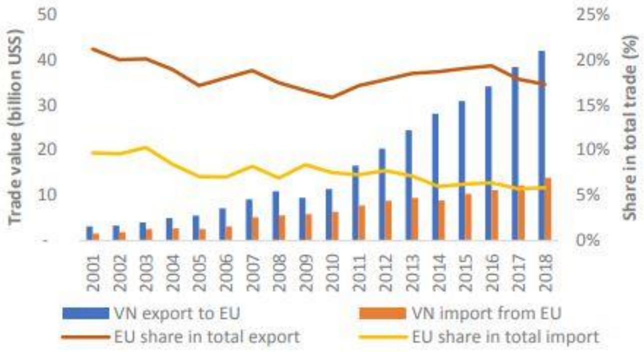
Table 2. Vietnam-EU Trade between 2015-2019

Year	Exports		Imports		Total exports & imports	
	Value (million USD)	Change (%)	Value (million USD)	Change (%)	Value (million USD)	Change (%)
2015	30,940.1	10.77	10,433.9	17.16	41,374.0	12.31
2016	34,007.1	9.92	11,063.5	6.03	45,070.7	8.93
2017	38,336.9	12.75	12,097.6	8.57	50,434.5	11.72
2018	41,885.5	9.42	13,892.3	13.95	55,777.8	10.59
2019	41,546.6	-0.81	14,906.3	7.30	56,452.9	1.21

Source: *Vietnam General Department of Customs (2020)*

According to data of Vietnam General Statistics, Vietnam's main exporting products to the EU are phones and components with total export reaching US $ 12.2 billion in 2019, footwear (reaching US $ 5 billion), computers and components with total export revenue reaching US $ 4.6 billion in 2019, textiles and garments (reaching US $ 4.2 billion), seafood (reaching over US $ 1.2 billion), coffee (reaching US $ 1.16 billion). Main European Member State markets with export value of more than US $ 1 billion in 2019 were the Netherlands, Germany, France, Italy, Austria, Spain, Belgium, Sweden and Poland .

Figure 10. Vietnam Exports to and Imports from EU

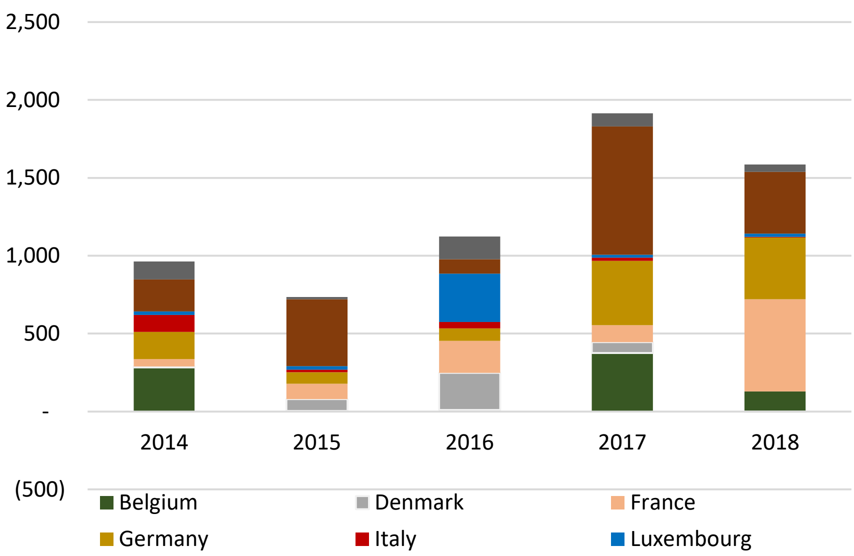


Source: Trade Map (2019)

The trade relationship between Vietnam and the EU have been improving over time in term trade value, and the EU is one of the most important markets of Vietnam exporters. From 2001 to 2018, the total value of exports from Vietnam to the EU had increased annually at a rate of 16% (figure 10). Similarly, the annual growth rate of Vietnam's imports from the EU was about 14% on average. The EU is the third-largest export market and the fifth-largest import market for Vietnam in 2019. EVFTA is expected to improve the bilateral trade performance between the EU and Vietnam from 2020. Vietnam has always maintained a trade surplus in trading with the EU in the past two decades.

As already mentioned, in 2019, the EU had 2,375 investment projects (an increase of 182 projects compared to 2018) from 27 European countries into Vietnam with a total registered capital of US $ 25.49 billion accounted for 7.70% of Vietnam's projects and accounted for 7.03% of the total registered investment capital. The investment trend of the EU is mainly focused on high-tech industries, however, there has been a tendency to focus more on service sectors (postal and telecommunications, finance, serviced offices, and retail).

Figure 11. EU Investment flow (inward) to Vietnam, 2014-2018 (million USD)



Source: EUROSTAT[15]

[15] The last FDI inflow available year is 2018.

Over the period of 2014-2018, the total FDI inflow from European Union to Vietnam had increased sharply from 962 million USD in 2014 to over 1,590 million USD in 2018 (the most FDI inflow available year) according to EUROSTAT. In 2018, France, Germany and Netherlands were the three countries with the highest values of FDI inflow to Vietnam (figure 11). Noticeably, the Netherlands invested about 823 million USD to Vietnam accounting for more than half of total FDI inflow of the EU to Vietnam in 2017.

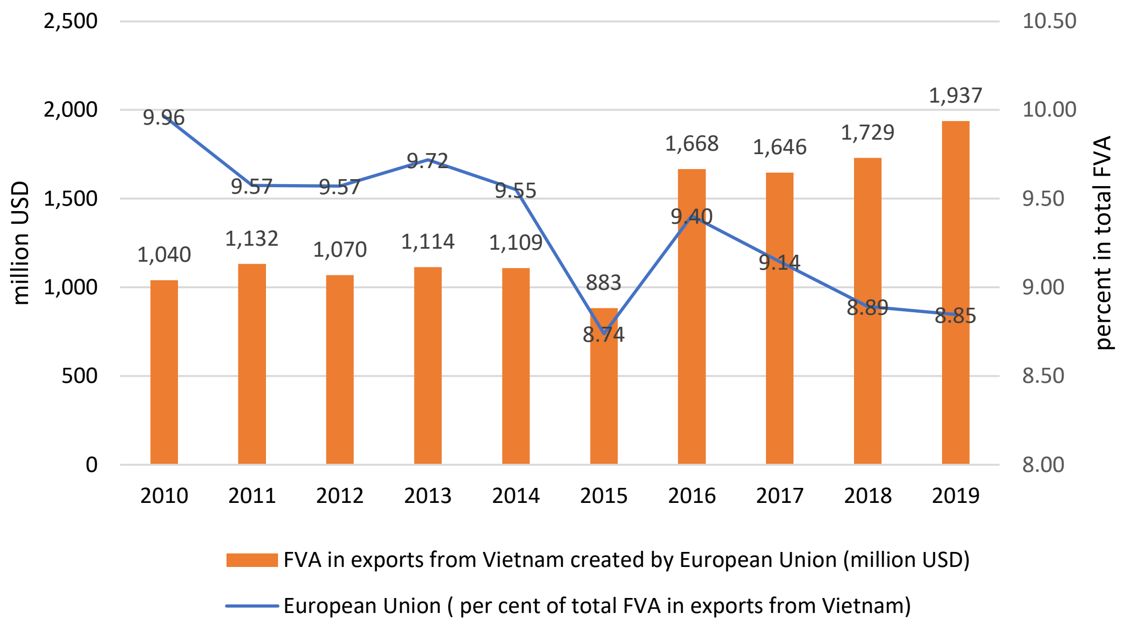
European countries remain extensively involved in cross-border production chains, and their GVC participation is relatively high compared with the world average and most other economies. Overall, the participation of the Euro area in GVCs is significantly higher than in the United States and China and is second only to that of central and eastern European countries (an overlapping category that includes five small Euro area economies). The smaller Euro area countries need to source a greater share of inputs from abroad, so that their participation in GVCs is higher than that of the bigger economies. In addition, the Euro area countries are more involved in regional than in global supply chains. It is also important to notice that, after 2011, the integration of Euro area countries into regional supply chains has declined to a lesser extent than its GVC participation with other countries. Larger European economies tend to lie more upstream in the global production chain than small Euro area countries. Compared with the world average, Euro area countries are moderately downstream, meaning that the foreign content of Euro area production is larger compared with the inputs supplied by the Euro area to other countries.

Regarding the top creators of value added in value added exports from Vietnam, the European Union has appeared in the list of top-five contributors to Vietnam's gross exports (see figure 4). In addition, foreign value added in exports from Vietnam which were imported from Europe accounted for 8.9 per cent of total foreign value-added exports from Vietnam in 2019. In which, the manufacturing sector accounted for largest share with approximately 64 per cent of total FVA created by European countries of exports from Vietnam (data from AJC-UNCTAD-Eora database on ASEAN GVCs).

Foreign value added in exports from Vietnam which were created by the European Union were 1,040 million USD in 2010. After almost ten years, this indicator increased nearly two times to 1,937 million USD in 2019 (figure 12). However, the share of FVA contributed by the EU in total FVA in exports from Vietnam had decreased from 9.96 per cent in 2010 to 8.85 per cent in 2019. The FVA rate contributed by the EU could be affected by the intermediate goods supply diversification strategy for export production of Vietnamese exporters.

The EU-Vietnam Free Trade Agreement (EVFTA) is a new generation FTA between Vietnam and the European Union. It is a comprehensive and high-quality agreement that ensures balanced benefits for both Vietnam and the EU, with consideration for the differences in development levels between the two sides. Upon entering into force, the EVFTA is expected to be a huge boost to Vietnam's exports, helping to diversify markets and exports, particularly agricultural and aquatic products as well as Vietnamese products with competitive advantages.

Figure 12. FVA contributed by the EU in total exports from Vietnam, 2010 - 2019



Source: *AJC-UNCTAD-Eora database on ASEAN GVCs and calculation by Economica Vietnam.*

The agreement includes 17 chapters, two protocols, and several attached memorandums, with main contents covering the following aspects: (1) trade in goods, services, (2) investment liberalization and e-commerce, government procurement, and (3) intellectual property rights. The EVFTA also covers other aspects including rules of origin, customs and trade facilitation, sanitary and phytosanitary measures, technical barriers to trade, sustainable development, cooperation, and capacity building, and legal-institutional issues.

The strong commitments on market opening in the EVFTA will certainly promote Vietnam - EU trade relations, helping to further expand the market for Vietnamese exports. With the commitments to abolish nearly 100% of import duties as agreed by both parties, there are huge opportunities to increase the export of Vietnamese products such as garments and textiles, footwear, agricultural and seafood products (including rice, sugar, honey, and vegetables), wood products, and others. Moreover, commitments on services, investment, government procurement as well as specific regulations on market opening and technical measures in some specific areas will also create opportunities for EU enterprises, products and services to have better access to the Vietnamese market of nearly 100 million people. Meanwhile, Vietnamese consumers will have easier access to high-quality products and services from the EU in the areas of pharmaceuticals, health care, infrastructure construction, and public transportation, among others.

In June 2018, Vietnam and the EU officially agreed to split the negotiated outcome into two agreements for reasons of internal ratification. After the *Investment Protection Agreement (EVIPA)* received the assent of the European Parliament in February 2020, the EVIPA was ratified by the Vietnamese National Assembly on the same day as the EVFTA. Once the European Union has finalized its ratification process – which requires the ratification by each of the national Member State parliaments, possibly even regional assemblies. It will replace the current 21 Bilateral Investment Treaties (BITs) with EU Member States. The EVIPA will modernize the BITs to protect investors and investments in a host country. It contains the most advanced and modern mechanism of addressing investment disputes between investors and the host State through the creation of a EU-Vietnam bilateral investment court.

EVFTA and EVIPA are expected to bring significant benefits for Vietnam. According to the Ministry of Industry and Trade, the EU is already now, while the EVFTA has just entered into force, the second-largest export market of Vietnam. In 2019, export turnover to the EU will hit about 41.8 billion USD. After the EVFTA comes into force, 85 percent of Vietnam's export tariff lines to the EU will be abolished, equivalent to 70.3 percent of export turnover. The number of tariff lines removed after seven years of this agreement will be more than 99 percent, equivalent to 99.7 percent of Vietnam's export turnover. This will be a great opportunity for Vietnam's exporters to increase their market share in the EU. For exporters coming from the EU, Vietnam will eliminate 48.5% of tariff lines (accounting for 64.5% of the total import value). After ten years, tariffs will be eliminated on about 98.3% of tariff lines which account for 99.8% of total import value. For the remaining of EU tariff lines, Vietnam could apply tariff quotas in compliance with the World Trade Organization (WTO) commitments. The EU and Vietnam also made commitments on how to treat investors in service sectors such as finance, telecommunications, transportation and distribution. In addition, the mechanisms of resolving disputes were set up by both the EU and Vietnam government.

The EU-Vietnam partnership, especially the EVFTA and EVIPA, will obviously support Vietnam in participating in GVCs. According to a research of MPI on the impact of EVFTA on Vietnam's economy, if the commitment to cutting down tariffs are fully implemented, the EVFTA will contribute to increase GDP on average about 2.18% to 3.25% (for the first five-year period of implementation), about 4.57% to 5.30% (for the next five-year period) and about 7.07% to 7.72% (for the following five years after that). The EVFTA is expected to increase exports of Vietnam to the EU by about 42.7% by 2025 and 44.37% by 2030 in comparison without implementation of the EVFTA. Regarding to total exports of Vietnam to the world, total exports are also expected to rise on average about 5.21% to 8.17% (for the first five-year period of implementation), about 11.12% to 15.27% (for the next five-year period) and about 17.98% to 21.95% (for the following 5 years after that). The MPI predicts that Vietnam will have many institutional upgrades and business environment improvements due to the implementation of the EVFTA and will help to attract foreign investors. Broad and in-depth commitments on investment of the agreement help Vietnam continuously renovate its economic structure, improve its institution and business environment, and facilitate EU investors to do their business in Vietnam. This will boost FDI inflow from the EU to Vietnam in the coming time.

EVFTA and EVIPA strengthen the expectation of accelerating high quality investment inflow from advanced economies when Vietnam opens its market of goods and services increasingly for European enterprises. This will create new impetus for FDI inflow.

Accordingly, investment structure may change when Vietnam attract new investment partners and areas. In Vietnam, FDI inflows have rooms to develop in some sectors in which the EU has strengths such as clean energy and renewable energy.

5. COVID-19 and its implications to Vietnam integrating into GVCs

5.1. Impacts of COVID-19 in GVCs globally

The COVID-19 pandemic has caused an unprecedented health and economic crisis worldwide. As a result, the global economy is expected to sink into a severe recession in 2020, much worse than the one of the 2008-09 financial crisis, while strong economic growth is expected to take place in 2021[16]. As the health and human toll grows, the economic damage is already evident and represents the largest economic shock the world has experienced in decades. The GDP losses are highly correlated to drops in employment. The EU has agreed on a coordinated temporary restriction on non-essential travel to the EU. This measure has a strong impact on international trade and especially tourism, which is a major player in the EU economy[17].

With COVID-19, GVCs are argued by some to create additional economic vulnerabilities during a pandemic or other crisis where international trade is disrupted. The closure of factories in China at the end of January drew attention to the reliance of many manufacturing value chains on inputs from China. The subsequent lockdowns implemented all over the world resulted in a GVC 'concussion' (Baldwin, 2020) and re-ignited a debate on the risks associated with international production.

COVID-19 is a global health crisis that has led governments and companies to take exceptional measures to protect the lives of citizens and workers. These measures have either reduced or stopped the economic activity, resulting in decreased output, rising unemployment, and falling demand. GVCs are impacted through four channels.

- *First,* there is a direct impact when companies operating in GVCs stop producing due to health precautions.
- *Second,* there is a range of indirect impacts, which can affect GVCs to differing degrees. There is a supply chain impact when production in one location requires inputs from another location and this other location is directly impacted. The supply chain impact can also stem from a disruption in international transport networks, where the disaster does not affect the production of inputs but rather the intermediary means

[16] See the most recent Spring Forecast published by the European Commission (2020a).
[17] EU response to economic consequences of COVID-19 available at https://www.interregeurope.eu/intra/news/news-article/8520/eu-response-to-economic-consequences-of-covid-19/

of transportation. International transport networks have also been impacted during the crisis through restrictions on the movement of people and additional requirements at the border for customs clearance.

- *Third,* there can be a demand impact, whereby production continues but fewer consumers are willing to buy the products.
- *Fourth,* there is also a trade and investment policy risk, as illustrated with export bans implemented for key medical supplies and growing pressure in some quarters to re-nationalize production in the belief that this will promote greater security of supply.

Widespread virus outbreaks throughout the Euro area have prompted governments to impose various mitigation measures such as nationwide lockdowns, extended school closures, and border restrictions. These have significantly disrupted domestic economic activity. Many Euro Area members are heavily reliant on tourism, a sector virtually shut down by government policies, and particularly prone to slow recoveries. In contrast to the United States, the rise in unemployment has been modest so far, in large part due to the widespread use of short-time work policies. U.S. unemployment has already surpassed the 2008 figures, as a result of the COVID-19 outbreak - and, with U.S. unemployment continuing to increase each week, it is now projected to exceed 20% by end of 2020 (US Bureau of Labor Statistics).

The June 2020 Global Economic Prospects of the World Bank describes both the immediate and near-term outlook for the impact of the pandemic and the long-term damage it has dealt with prospects for growth. The baseline forecast envisions a 5.2 percent contraction in global GDP in 2020, using market exchange rate weights—the deepest global recession in decades, despite the extraordinary efforts of governments to counter the downturn with fiscal and monetary policy support. Over the longer horizon, the deep recessions triggered by the pandemic are expected to leave lasting scars through lower investment, an erosion of human capital through lost work and schooling, and fragmentation of global trade and supply linkages. For emerging markets and developing countries, many of which face daunting vulnerabilities, it is critical to strengthen public health systems, address the challenges posed by informality, and implement reforms that will support strong and sustainable growth once the health crisis abates. Euro area output is expected to contract by 9.1 percent in 2020—10.1 percentage points below previous projections—with all major member countries experiencing recessions before a gradual recovery gets underway late in the year. Growth is forecast to rebound to 4.5 percent in 2021, reflecting fading pandemic-related drag, and the eventual effects of accommodative fiscal and monetary policy.

Overall, given the unprecedented nature of the COVID-19 crisis, any attempts at projecting the actual impacts on American and European consumption levels are highly uncertain. In the case that COVID19 is managed well and relatively controlled in Europe and the U.S., the most notable impact is likely to be a dip in consumption lasting for several months.

5.2. Impacts of COVID-19 in GVCs in Vietnam

In 2019, there were about 11,000 and 1,800 registered enterprises in Vietnam in the sectors of (1) textile/garment and (2) consumer electronics manufacturing, respectively. These companies employed about 3 million workers in 2019. Taking into account the other manufacturing enterprises that rely directly upon these two sectors (e.g. the subcontractors of and the suppliers to the textile/garment and consumer electronics manufacturers), the total number of employees who work in these sectors would be closer to 10 million.

The Vietnamese textiles industry remains largely driven by small and medium local enterprises, working as contracted manufacturers to foreign clients in Europe, the U.S., and China. These small and medium enterprises (i.e. enterprise with annual revenues of less than US$ 50 million) are estimated to account for more than 50% of the sector. The sector in Vietnam is largely composed of small "cut, make, and trim" ("CMT") companies, which conduct their work at the very final stages of the manufacturing value chain. A few of these companies have been able to move to the FOB (free-on-board) level. FOB term in the Vietnamese textile and garment industry means "buying raw materials, selling products" that suppliers receive payment for full price of the garment exported, not just the assembly part (CMT) of the production process. Unlike CMT, exporters using FOB actively buy necessary materials inputs instead of being supplied directly from their buyers. Furthermore, Vietnamese CMT textile companies are labor-intensive, and relatively low-margin businesses (with a 5 to 10% net profit, on average, as compared to 15 to 20% for FOB textile companies). A recent survey that was conducted by Dragon Capital in the 1st quarter 2020 revealed that CMT companies have already lost 20 to 30% of their orders for the 1st quarter, as compared to the first quarter of 2019. The impact of the COVID-19 outbreak in the second quarter may be of even greater magnitude, given the prospects for the U.S. and Europe. For the textiles/garment industry in Vietnam, the COVID-19 crisis may accelerate (i) the recently observed trend of concentration, and (ii) a shift towards increased value-added activities by moving to FOB activities.

Regarding consumer electronics/phones/computers and parts, the sector is largely driven by large international companies that have recently relocated elements of their production to Vietnam. For such companies, their exposure to the COVID-19 crisis is not likely to be as critical as for the Vietnamese textiles/garment sector. Even so, such companies can expect to face a contraction of 10 to 20% in their orders for 2020 (as a projection of IDC, CSS Insight, PwC Research, and Analysis), as compared to 30 to 40% contraction for textiles firms.

5.3. Policy responses by Vietnam in the aftermaths of the COVID-19 from the GVC perspective.

A series of solutions from the Vietnamese government to support businesses to overcome great difficulties and challenges caused by the COVID-19 pandemic has been implemented in a short time.

The Government issued Decree No. 41/2020/ND-CP dated April 8, 2020, on extending the deadline for paying taxes and land rents. At the same time, the Government issued a number of important documents to step up the direction, administration, reform of administrative procedures, development, and application of information technology to create a favorable business environment and remove difficulties for businesses affected by COVID-19, such as

Decree No. 45/2020/ND-CP dated on April 8, 2020, on implementation of the above administrative procedures.

A number of specific solutions, such as boosting exports, especially to markets that may soon see an end of the pandemic such as Korea, China, Japan, especially exploiting markets having free trade agreements with Vietnam. The government also considers having a credit guarantee policy for new loans of customers seriously affected by COVID-19 and labor-intensive businesses such as tourism, textile, footwear and aviation, specifically SMEs.

The government also urgently guided the implementation of the National Assembly's Resolution on reducing enterprise income tax in 2020 and guided the implementation of a time-limited interest rate in a subsidy policy for SMEs in accordance with the Law on SME Support to recover enterprise production and job creation.

The government had implemented policies to expand lending subjects of the SME Development Fund by adding more funds for it in order to better cope with the COVID-19 epidemic. The government also encourages the construction of digital platforms to help Vietnamese businesses promote online-trading. Ministries and branches are promoted to introduce business connection platforms; support the development of e-commerce platforms; e-logistics, electronic payment transaction, technology applications, fintech, mobile money.

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Appendix 1. Description of Free Trade Agreements that Vietnam involved

No.	FTA	Description and Status	Partners
FTAs which came into force			
1	AFTA	The Association of Southeast Asian Nations (ASEAN) was established in 1967 with the aim of enhancing the multilateral cooperation in the field of economics, politics and socio-culture among 10 South East Asian countries, including Singapore, Thailand, Indonesia, Malaysia, Philippines, Brunei, Vietnam, Myanmar, Cambodia and Lao. ASEAN Community is comprised of three primary pillars, namely the ASEAN Political-Security Community, the ASEAN Economic Community and the ASEAN Socio-Cultural Community. The ASEAN Economic Community (AEC) is to be set up on December 31st, 2015. One of the main purposes of AEC is to create a single market and production base in the region. Such purpose has been progressively fulfilled through the Agreement on Free Trade in Goods, Services, Investment in ASEAN and many other Programs, Initiatives, etc.	ASEAN
2	ACFTA	ASEAN and China signed the Framework Agreement on Comprehensive Economic Co-operation in November 2002. The Parties, on the basis of this Framework Agreement, signed the Agreement on Trade in Goods (effective from July, 2005), Agreement on Trade in Services (effective from July, 2005), and Agreement on Investment (effective from February, 2010) with the aim of establishing an ASEAN – China Free Trade Area. In Nov 2015, ASEAN and China signed the Protocol to Amend the ACFTA and Certain Agreements thereunder between ASEAN and China, including some new commitments in terms of Goods, Services and Investment. This Protocol came into force in May 2016.	ASEAN, China
3	AKFTA	ASEAN and Korea entered into the Framework Agreement on Comprehensive Economic Cooperation in 2005. On the ground of the Framework Agreement, the parties signed 04 other Agreements, namely Agreement on Trade in Goods (effective from June, 2007), Agreement on Trade in Services (effective from May, 2009), and Agreement on Investment (effective from June, 2009) with the aim of establishing an ASEAN – Korea Free Trade Area	ASEAN, Korea
4	AJCEP	ASEAN and Japan signed the ASEAN-Japan Comprehensive Economic Partnership (AJCEP) in April 2008. This agreement, which came into effect from December 1st, 2008, includes commitments on trade in goods, services, investment and economic co-operation	ASEAN, Japan

5	VJEPA	The Agreement between Vietnam and Japan for an Economic Partnership (VJEPA) was signed on December 25th, 2008 and came into force on October 1st, 2009. This is the very first bilateral FTA of Vietnam, in which both Vietnam and Japan give the other more preferences than that agreed under the Agreement for Comprehensive Economic Partnership ASEAN – Japan (AJCEP). However, VJEPA does not replace AJCEP. These two FTAs coexist, and enterprises can choose to use the more favorable one.	Vietnam, Japan
6	AIFTA	ASEAN and the Republic of India went into the Framework Agreement on Comprehensive Economic Cooperation on October 8th, 2003. The Parties, on the basis of the Framework Agreement, signed an Agreement on Free Trade in Goods (effective on January 1st, 2010), an Agreement on Free Trade in Services (effective on July 1st, 2015) and an Agreement on Investment (effective on July 1st, 2015) with the aim of establishing an ASEAN – India Free Trade Area.	ASEAN, India
7	AANZFTA	ASEAN, Australia and New Zealand signed the Agreement Establishing the ASEAN –Australia – New Zealand Free Trade Area on February 2nd, 2009, which came into effect from January 1st, 2010. Such agreement is quite comprehensive, containing detailed commitments on goods, services (also including financial and telecommunications services), investment, electronic commerce, movement of natural persons, intellectual property, competition policy and economic co-operation.	ASEAN, Australia, New Zealand
8	VCFTA	The Free Trade Agreement between the Government of the Republic of Chile and the Government of the Socialist Republic of Vietnam was signed on November 11th, 2011 and came into effect on January 1st, 2014. This FTA contains only commitments on goods and goods-related matters, there are no commitments on services and investment. Such FTA is the very first FTA between Vietnam and a South American country.	Vietnam, Chile
9	VKFTA	VKFTA was signed on May 5th, 2015 and officially came into effect on December 20th, 2015. Compared to FTA ASEAN – Korea (AKFTA), VKFTA contains more preferences that the Parties give to each other in the field of goods, services and investment. However, VKFTA does not replace AKFTA. These two FTAs coexist, and enterprises can choose to use the more favorable one.	Vietnam, Korea
10	VN – EAEU FTA	Free Trade Agreement between Vietnam and Eurasian Economic Union (EAEU - including Russia, Armenia, Belarus, Kazakhstan and Kyrgyzstan) was officially signed on May 29, 2015, and took effect from October 5, 2016. This is the first FTA	Vietnam, Nga, Belarus, Armenia,

		of EAEU, which brings many export opportunities to Vietnamese businesses	Kazakhstan, Kyrgyzstan
11	CPTPP (Former name: TPP)	In November 2017, Trade ministers from 11 member countries of the Trans-Pacific Partnership (TPP) had agreed on core elements of the pact, which is from now on called the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP). In March 2018, CPTPP was officially signed by 11 country members (excluding United States). CPTPP came into force in Vietnam on the 14^{th} January 2019.	Vietnam, Canada, Mexico, Peru, Chile, New Zealand, Australia, Japan, Singapore, Brunei, Malaysia
12	AHKFTA	Hong Kong (China) and ASEAN commenced negotiations of a Free Trade Agreement (FTA) and a related Investment Agreement in July 2014. After ten rounds of negotiations, Hong Kong and ASEAN announced the conclusion of the negotiations in September 2017. Both Agreements were signed on the 12^{th} November 2017. The FTA came into effect from 11 June 2019, and the Investment Agreement came into effect from 17 June 2019 in Hong Kong (China) and 5 ASEAN members (Laos, Myanmar, Singapore, Thailand and Vietnam)	ASEAN, Hongkong (China)
13	EVFTA	On December 1st, 2015, the negotiation rounds of EVFTA was officially announced to be concluded, and its official full text was published on February 1st, 2016. On 26 June 2018, EVFTA was divided into two Agreements in terms of trade and investment. At the same time, the legal review of Investment Protection Agreement (IPA) and EVFTA's final text was formally concluded. Both Agreements were signed on 30 June 2019. EVFTA and EVIPA were ratified by the European Parliament on February 12, 2020 and approved by the Vietnamese National Assembly on June 8, 2020. For EVFTA, after ratification, this Agreement came into force on August 1, 2020. For EVIPA, on the EU side, the Agreement will still need to be further ratified by the Parliament of all 27 EU member states (after the UK completes Brexit) to take effect.	Vietnam, EU (27 members)
FTAs in negotiating			
14	RCEP	The negotiations of the Regional Comprehensive Economic Partnership between ASEAN and the six states with which ASEAN has existing FTAs (including China, Korean, Japan, India, Australia and New Zealand) were launched in May 9th, 2013. Currently they are still under negotiation.	ASEAN, China, Korea, Japan, India, New Zealand

15	Vietnam – EFTA FTA	The negotiations of Free Trade Agreement (FTA) between Vietnam and EFTA States (including Norway, Switzerland, Iceland, and Liechtenstein) was officially launched from May 2012 and is currently still under negotiation.	Vietnam, EFTA (Switzerland, Norway, Iceland, Liechtenstein)
16	Vietnam – Israel FTA	The negotiations of the Free Trade Agreement between Vietnam and Israel were officially launched from December 2nd, 2015 and is still under negotiation	Vietnam, Israel