

# Is Vietnam the Next China? Preparing for the Post-Pandemic Decoupling



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The trade dispute between the United States and China has led supply chains to move out of China and into alternative destinations such as Vietnam. The great decoupling gained substantial momentum during the Covid-19 crisis as it exposes countries to the danger of over-reliance on China, especially for the production of their medical supplies. The Trump administration is turbocharging the decoupling initiatives as the pandemic continues to shake the global economy.<sup>1</sup> A notable initiative is the “Economic Prosperity Network”, which includes Australia, India, Japan, New Zealand, South Korea, and Vietnam, to restructure supply chains and reduce economic dependence on China.

In addition to creating a new economic alliance, the United States and Japan have pledged as much as \$25 billion<sup>2</sup> and \$2 billion<sup>3</sup> in a “reshoring fund” to bring companies back to their respective homes. Because the reshoring fund is not sufficient, however, a significant share of companies will search for alternative destinations besides their home countries. The United States can either diversify supply chains to Mexico for geographical proximity (i.e., nearshoring) or other low-cost countries (LCCs). Many MNEs will choose the LCC option over nearshoring when they do not have neighbors with low wages, sufficient absorptive capacity, decent economic size, and advanced institutional development. In a post-pandemic era, the key determinant of global value chain (GVC) participation will include crisis management, as companies are looking to build more resilient supply chains in response to a global health crisis.

For that reason, MNEs will consider Vietnam as an alternative destination for its cheap labor, liberalized trade and investment policies, and government stability. The nation's exceptional crisis-management during the pandemic reinforces its viability as a manufacturing hub in a post-pandemic era. Apple will produce its popular wireless earphones (AirPods) in Vietnam for the first time outside China,<sup>4</sup> Samsung will relocate a computer factory from China to Vietnam,<sup>5</sup> and 15 Japanese firms are expected to move production from China to Vietnam.<sup>6</sup> Vietnam also has been establishing solid economic international linkages through several free trade agreements such as the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) and the EU-Vietnam FTA (EVFTA) which entered into force in January 2019 and August 2020, respectively.

In contrast, several factors may restrain Vietnam from becoming the new manufacturing hub. Vietnam's population size of 95 million is much smaller than China's 1.4 billion, with Vietnam's workforce at a mere 7% the size of China's.<sup>7</sup> MNEs may have to compete for labor with other foreign corporations, which may lead to a rise in labor costs. Vietnam's GDP is much smaller than China's, which corresponds to a smaller domestic consumer market. Infrastructure does not meet all the household and commercial electricity demands. As MNEs are searching for factory sites, the land price will increase. In terms of container shipping capacity, Ho Chi Minh City can only process up to 6.15 million containers per year, which pales in comparison with 40 million containers being processed in Shanghai annually.<sup>8</sup> In sum, it is uncertain whether Vietnam can accommodate the different needs of MNEs amid the new wave of the manufacturing exodus from China.

The decoupling process will inevitably continue regardless of the outcome of the U.S. presidential election in November, considering that Republicans and Democrats both agree that there needs to be a check on China's power. Assuming that the great decoupling could outlast the Trump administration and even the pandemic, companies must prepare for the effects of reshoring and redistribution of supply chains. The information and communication technology (ICT) industry will be the major battleground for the U.S.-China trade war. For instance, the U.S. "entity list"<sup>9</sup> has blocked shipments to major Chinese firms such as Huawei Technologies and China retaliated with the "unreliable entity list",<sup>10</sup> which is Beijing's response to Washington's economic sanction. As these blacklists continue to target sectors that use South Korean semiconductors, it is paramount to find a strategy that can minimize the adverse effects of the decoupling process.

Weighing the advantages and drawbacks of the situation, South Korea must assess policy implications from the current state of events. Particularly, South Korea can expect two major challenges amid the post-pandemic decoupling era. First, if a substantial share of global supply chains is heading to Vietnam, South Korean firms will have to compete for labor with other MNEs. Second, the great decoupling poses a quandary for South Korea, as it is one of the U.S. allies with high economic dependence on China and will have to make strategic choices. As the political and economic uncertainty continues, South Korea can prepare for the following prospects in GVCs.

## 1. “China plus one” or “China plus two” strategies

As the decoupling process drags out and the pandemic persists, South Korean firms will diversify supply chains and move factories out of China. Some will be reshoring back home and some will choose nearshoring when bringing factories back home is too costly. Considering the existing investment partnership and economic ties with Vietnam, a substantial number of South Korean firms will consider Vietnam as a viable nearshoring candidate. However, Vietnam’s smaller workforce and limited production capacity compared to China’s will prevent all South Korean foreign subsidiaries from moving to Vietnam from China, meaning that it is yet premature to shift all production to Vietnam. Therefore, the so-called “China plus one” or “China plus two” strategies, which involve diversifying supply chains to other nations while keeping essential operations in China, will be both desirable and necessary.

## 2. Vietnam’s global networks

According to Paragraph 7, Article 3 in Chapter 4 of the EVFTA agreement, “*Fabrics originating in the Republic of Korea shall be considered as originating in Vietnam when further processed or incorporated into one of the products listed in Annex V to this Protocol obtained in Vietnam, provided that they have undergone working or processing on Vietnam which goes beyond the operations referred to in Article 6 (Insufficient Working or Processing).*”<sup>11</sup> In other words, clothes produced in Vietnam using South Korean fabrics will receive the same tariff reductions as any other Vietnamese products. South Korean firms operating in the related industrial sectors can benefit from Article 3, or the “Cumulation of Origin” clause of the EVFTA agreement, as the firms can expand supply chains by utilizing relationship-specific foreign investments. A careful examination of future Vietnamese global networks can also lead to new opportunities for economic cooperation.

## 3. Technological innovation in GVCs

The future of GVCs entails digital platforms, automation, and 3D printing, which will drastically change the core aspects of offshoring.<sup>12</sup> Understanding the implications of the new GVC determinants and constructing well-tailored policies will also be critical for responding to the post-pandemic decoupling phenomenon. Digital platforms will reduce fixed costs as firms can match buyers and sellers without constructing physical plants abroad. Automation will reduce variable costs as firms can replace foreign workers with robotics that perform routine tasks. 3D printing will reduce dependence on foreign inputs. MNEs and the government should target private and public investments towards establishing a digital platform, substituting unskilled labor, and diversifying input sources with accommodating different needs of heterogeneous sectors. It is vital that the private and public sectors recognize the new wave of technological innovation and incorporate the changes into organizing more resilient and efficient GVCs.

With the ongoing global health crisis and the great decoupling process, the prospects of GVCs are perplexing. While many companies are shifting production out of China and relocating to Vietnam, it may take a while until “Made in Vietnam” replaces “Made in China”, considering the smaller production capacity in Vietnam. Instead, “Made in the World” may be a more apt term for describing the current outlook in GVCs. In the new era, maintaining a “China plus one” strategy and cooperating with Vietnam’s increasing global linkages are workable policy choices for South Korea. In the long-run, investing in digital platforms, automation, and 3D printing that will transform GVC participation is paramount when engineering a more resilient production network. **KIEP**

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<sup>1</sup> <https://www.reuters.com/article/us-health-coronavirus-usa-china/trump-administration-pushing-to-rip-global-supply-chains-from-china-officials-idUSKBN22G0BZ> (accessed on August 23, 2020)

<sup>2</sup> <https://www.reuters.com/article/us-usa-china-supply-chains/u-s-mulls-paying-companies-tax-breaks-to-pull-supply-chains-from-china-idUSKBN22U0FH> (accessed on August 23, 2020)

<sup>3</sup> <https://www.bloomberg.com/news/articles/2020-04-08/japan-to-fund-firms-to-shift-production-out-of-china> (accessed on August 23, 2020)

<sup>4</sup> <https://asia.nikkei.com/Business/Technology/Apple-to-produce-millions-of-AirPods-in-Vietnam-amid-pandemic> (accessed on August 23, 2020)

<sup>5</sup> <https://asia.nikkei.com/Business/Electronics/Samsung-to-end-Chinese-PC-production-as-costs-soar> (accessed on August 23, 2020)

<sup>6</sup> <https://e.vnexpress.net/news/business/companies/15-japanese-firms-opt-for-vietnam-after-china-4132810.html> (accessed on August 23, 2020)

<sup>7</sup> <https://carnegieendowment.org/2020/06/18/is-vietnam-eating-into-china-s-share-of-manufacturing-pub-82094> (accessed on August 23, 2020)

<sup>8</sup> <https://asiatimes.com/2020/05/why-made-in-vietnam-wont-replace-made-in-china/> (accessed on August 23, 2020)

<sup>9</sup> <https://www.bis.doc.gov/index.php/policy-guidance/lists-of-parties-of-concern/entity-list> (accessed on August 23, 2020)

<sup>10</sup> <https://www.reuters.com/article/us-usa-huawei-tech-china/china-ready-to-put-apple-other-u-s-companies-in-unreliable-entity-list-global-times-idUSKBN22R1X2> (accessed on August 23, 2020)

<sup>11</sup> <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=OJ:L:2020:186:FULL&from=EN#page=23> (accessed on August 23, 2020)

<sup>12</sup> <https://www.nber.org/papers/w26539.pdf> (accessed on August 23, 2020)