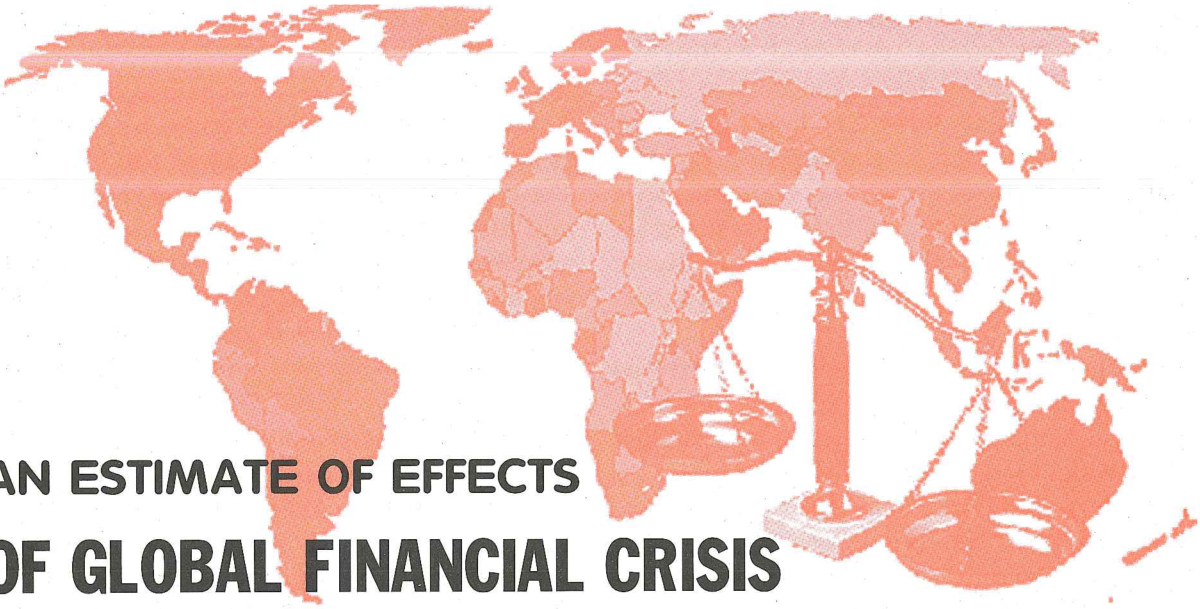

AN ESTIMATE OF EFFECTS OF GLOBAL FINANCIAL CRISIS ON THE BALANCE OF PAYMENTS

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In recent months, many leading financial institutions in the U.S. and Europe have gone bankrupt, got acquired and waited for governmental rescue. The global financial crisis affected seriously these economies, which led to predictions of a much lower growth rate. This situation affects Vietnam to a certain extent. With lessons from the 1997 Asian financial crisis, Vietnam should estimate exactly effects of the financial crisis in order to work out possible scenarios and suitable solutions, thereby minimizing unfavorable impacts and making the best use of opportunities if any.

This article examines items of the balance of payments in order to identify effects of the global financial crisis because this balance reflects all transactions between Vietnam and the world. These items are numerous, such as export, import, immigrant remittance, direct investment, indirect investment and foreign debt, etc, this article, however, limits itself to export, import, immigrant remittance, direct investment, and indirect investment; and doesn't examine the ODA and foreign debt because these flows of capital are realized according to agreements between governments.

1. Foreign trade

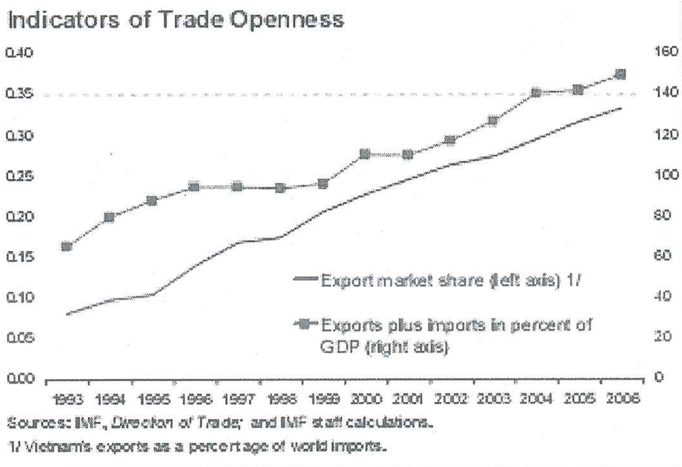
Generally, Vietnamese foreign trade will be affected seriously because (i) Vietnam's trade openness (ratio of foreign trade value to the GDP) is high: it rose from 40% in 1993 to 140% in 2006 and some 160% in 2008 [see Figure 1]; (ii) Vietnam is among the world's top 50 countries in terms of export and import values (the 50th biggest exporter and 41st biggest importer, according to the International Trade Statistic 2008); and (iii) The U.S., Europe and Japan account for 53.6% of Vietnam's export value (see table 1) while the U.S. alone represents 20.4%. These economies are suffering recession and falls in investment and spending, which reduces Vietnam's export value

Table 1: Vietnam's export markets in 2008 (US$ million)

Market	Value	As % of total
EU	10,853,004	18,60%
ASEAN	10,194,815	17,50%
The U.S.	11,868,509	20,40%
Japan	8,537,938	14,60%
Australia	4,225,188	7,20%
China	4,535,670	7,80%
Total export value	58,281,775	100,00%

Source: Author's calculations based on data published by the GSO

Figure 1: Vietnam's trade openness in 1993-2006



Source: IMF Country Report No 07/385

On closer examination the Vietnam's export increased steadily in 2007 and up to July 2008, when it started falling. Recent information from the GSO shows that the export value in January 2009 fell by 18.6% compared with December 2008 and by 24.2% compared with January 2008. The General Customs Office also informed that prices of some staple exports, such as oil, rubber, rice, coffee, cashew nut and bean are all falling. The volume of goods exported to the U.S., the EU, and Japan fell by 20% - 30%. It's difficult to win new export contracts while many valid contracts are delayed.

Although proportion of manufactured goods in export has increased, from some 30% in 1993 to some 45% in 2007, but it is still low in comparison with neighboring countries. In 2001, the share of manufactured goods in the export value of Thailand, Indonesia, Singapore, China, and the Philippines were 74%, 80%, 56%, 85%, 89% and 91% respectively (World Development Indicators 2004).

The import is also affected seriously because: (i) from 70% to 80% of raw materials for the manufacturing sector are imports and import falls when the export falls; and (ii) international recession makes prices of essential inputs, such as oil, petrochemicals, steel and machines, fall, which lowers the import value.

The crisis also makes Vietnam's trade gap bigger. Although Vietnam's imports are mainly raw materials and capital goods, the huge trade gap may increase foreign debt and reduce the foreign exchange reserve when capital inflows are cut.

2. Direct investment

The global financial crisis brought many countries to the brink of recession, including countries and territories that account for some 50% of direct investment in Vietnam (see Table 3). The crisis also contract the supply of credits with the result that many lending contracts can't be carried out, disbursement will be slower while the loan capital accounts for over 30% of the foreign direct investment in Vietnam (see Box). This means that the FDI in Vietnam in the coming years may fall remarkably. The following table presents the FDI in Vietnam up to Dec. 19, 2008 and only valid projects that account for 5% of total FDI are included.

Table 2: Vietnam's import and export from January 2007 to November 2008 (US$ billion)

Month	Jan	Feb	Mar	April	May	June	July	Aug.	Sep	Oct	Nov	Dec
2007 export	3,76	2,89	3,86	3,64	4,08	4,17	4,25	4,30	3,77	4,30	4,50	4,68
2007 import	4,33	3,44	4,43	4,45	5,28	4,96	5,22	5,29	4,90	5,60	6,00	4,33
2007 trade gap	-0,57	-0,60	-0,60	-0,80	-1,20	-0,80	-1,00	-1,00	-1,10	-1,30	-2,00	0,35
2008 export	4,91	3,33	4,83	5,00	5,75	6,20	6,55	6,00	5,27	5,04	4,80	
2008 import	7,20	6,04	8,07	8,24	7,67	6,93	7,30	6,28	5,51	5,71	5,30	
Trade gap	-2,29	-2,70	-3,20	-3,20	-1,90	-0,70	-0,80	-0,30	-0,20	-0,70	-1,00	

Source: Author's calculation based on statistics by GCO

The Vietnam's export has many shortcomings that hinder development of sustainable export markets. Some of them are: (i) quality of exports is low and inconsistent while the price is not as low as the quality; (ii) trade promotion is poor and delivery is not sure; (iii) ways of selling goods are not flexible; (iv) staple exports are farm products and natural resource and Vietnam therefore is easily affected by fluctuations in prices.

Table 3: FDI in Vietnam in 1998-2008 (US$)

Rank	Country	Project	Total investment	Chartered capital	As %
1	Taiwan	1,940	19,650,567,091	7,816,779,142	13,10%
2	Malaysia	302	17,783,408,023	3,812,797,776	11,90%
3	Japan	1,046	17,158,201,448	4,875,799,623	11,50%
4	South Korea	2,058	16,526,117,830	5,862,630,195	11,00%
5	Singapore	651	15,438,025,346	5,132,305,330	10,30%
6	British Virgin Islands	404	11,704,426,217	3,917,299,736	7,80%

Source: Author's calculations based on *Đầu tư trực tiếp nước ngoài* 1988-2008 (FDI in 1988-2008) published by the MPI.

Characteristics of the FDI in Vietnam

The Foreign Investment Law requires that "total investment of a project should include at least 30% of the legal capital contributed by the two parties." This means that project owners may fill the difference between total investment and legal capital with loan capital. Foreign-invested companies usually seek for such loan from foreign sources because the supply of credit from local ones is limited with the result that the FDI in Vietnam includes big loans. The loan capital tends to increase over years (it got bigger than the equity capital in 1994-99) and debt repayment becomes a burden to the foreign sector. From 1995 on, debt repayment from this sector increased steadily and reached its peak in 2001 (US$819 million).

FDI Capital structure in 1993- 2008 (US$ million)

Indicator	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006[e]	2007[e]	2008[e]
Equity capital	594	454	791	891	1,002	240	301	977	1,067	1,904	1,294	1,283	1,204	1,605	1,896	2,086
Loan capital	238	594	989	921	1,072	560	399	124	185	141	600	595	750	795	936	1,030
Equity capital/ Total capital (%)	71	43	44	49	48	30	43	89	85	93	68	68	62	67	67	67
FDI debt repayment			36	55	174	372	603	601	819	414	590	536	524	643	793	952

Source: Thành (2002), IMF (2003), IMF (2005), IMF[c] (2007).

3. Indirect investment

Flows of indirect investment to Vietnam in the coming years will be affected to a certain extent because: (i) psychological effects on global stock exchanges are felt and the VN-Index for example continuously went through the floor and fell to a record low level of 252.57 on Feb. 2, 2009; and (ii) international financial institutions should re-examine their investment strategies and port folios. Investors may sell their share to preserve their capital. Withdrawal of capital by foreign investors who control 40% - 50% of traded value and from 25% to 30% of shares in the Vietnamese stock market will affect badly the foreign exchange reserve and prices of commodities.

Selling off the share and withdrawing from the Vietnamese stock market is not easy because: (i) Most foreign investment funds in Vietnam are the closed ones specializing in long-term investments therefore they can't withdraw quickly; (ii) The Vietnamese stock market is of small size and doesn't account for a big share in the funds; and (iii) capital accounts in Vietnam are not liberated fully, which makes it difficult to withdraw the capital from the market or invest in foreign markets.

4. Immigrant remittance

Immigrant remittance is an important source of foreign exchange for Vietnam. According to an UN survey, Vietnam was among the world top 10 countries in receiving the immigrant remittance in 2006-07. With an average growth rate of 10% a year, the immigrant remittance is getting bigger than the ODA and direct investment put together.

The remittance to Vietnam comes from two main sources: wages of guest workers and students who make studies and work in foreign countries, and money from Vietnamese expatriates. The Table 4 shows that this source of foreign exchange increases over years because: (i) More and more Vietnamese people go abroad to work, study and live; and (ii) Policies on travel, immigration, and transfer of money are more open and banking services are more effective.

Table 4: Immigrant remittances to Vietnam in 1993-2008 (US$ million)

Year	Remittance	Year	Remittance	Year	Remittance	Year	Remittance
1993	141	1997	400	2001	1,820	2005	3,800
1994	250	1998	950	2002	2,100	2006	4,700
1995	285	1999	1,200	2003	2,700	2007	5,500
1996	469	2000	1,757	2004	3,200	2008	8,000

Source: Kinh tế Việt Nam và thế giới 2007-2008

In the near future, this source may reduce because (i) the market for guest workers may contract and many of them will have to return home due to joblessness; and (ii) income of Vietnamese expatriates reduces during the financial crisis. In addition, part of the immigrant remittances are put in securities and real estate and the flow to these businesses may reduce when they are not as profitable as in previous years. Numerical data about the immigrant remittances are not exact because no effective measures to encourage expatriates to use formal channels for remittances have been taken.

5. Solution

To minimize unfavorable effects of the financial crisis, Vietnam should improve its balance of payments, and the most effective measure is to increase the export and reduce the import, thereby reducing the trade gap.

a. Export: Measures to maintain traditional markets and enter into the new ones are:

(i) The plan to promote the export in 2006 - 2010 must be carried out at reasonable rate. Full attention must be paid to export of services, especially labor and tourism. Incentives can be given to production of exports and inputs for exports- making industries (exemption of import taxes on machines and raw materials for the footwear industry for example).

As for the tourism, it should be specialized and developed according to a long-term plan: creating diverse recreation grounds and supplying souvenirs that reflects the local cultures instead of investing too much in restaurants and hotels.

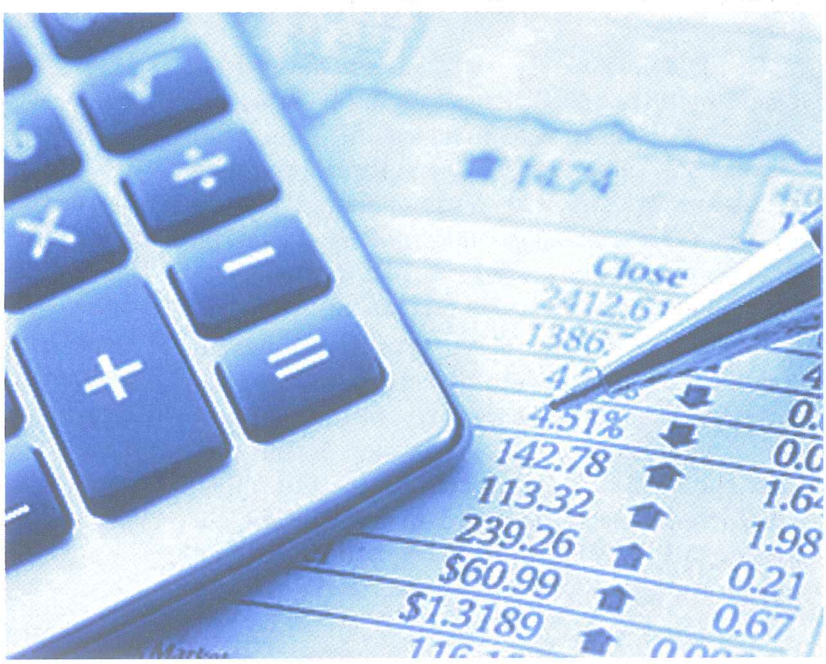
As for export of labor, the most urgent task is to prevent laborers from quitting their contracted workplaces by promulgating regulations on responsibility of banks, labor brokers, local governments and families in controlling the guest workers, along with proper sanctions. Recruitment and training for potential workers must be transparent.

In addition, structure of exports must be changed favorably by promoting the export of goods of increased prices, such as software, electronic equipment and parts, etc.

(ii) The supply of business information and role of trade representatives in foreign countries must be beefed up. Local companies should enhance the trade promotion activity, and take part in trade fairs to seek for partners.

(iii) Domestic market of 82 million people must be tapped properly. New markets, such as Middle East and ASEAN bloc, must be developed in order to avoid dependence on major markets and distribute business risks.

b. Import: The Vietnamese economy still depends on imported raw materials, and many industries rely on subcontracts or only undertake assembling jobs. This situation shows reflects in the following facts: (i) import of machines and raw materials accounts for 80% of import value; and (ii) two fastest growing industries, clothing and



footwear, depend totally on imported raw materials.

Import policy must be reformed and aims at: (i) reducing the import of consumer's goods and importing raw materials selectively with a view to encouraging local import-substitute industries; (ii) reducing wasteful use of resources, avoiding the use of obsolete and power- consuming technologies; reducing the import of raw materials for industries of low profitability, such as sugar, paper, cement, and steel; and (iv) importing high technologies and modern equipment that are sold off because of economic recession.

c. Foreign investment:

- To attract foreign investment, various methods must be employed, especially the ones of mobilizing indirect investment such as issue of shares on foreign stock exchanges, in order to reduce the proportion of loan capital to foreign direct investment.

- To promote the indirect investment, Vietnam should (i) have perfect the legal infrastructure for the stock market in which limits on proportion of shares held by foreign investors, fields open to them, and ways to transfer capital to and from Vietnam are clearly defined; and (ii) encourage privatized, joint stock and foreign-invested companies to go public.

- To promote the direct investment, it's necessary to (i) give incentives and other forms of preferential treatment; and (ii) improve the business climate with a view to reducing costs and increasing profits.

In the effort to attract the FDI, authorities should note that (i) FDI projects my be risky because of high-interest loan capital; (ii) foreign investors may make the trade gap bigger when they invest in protected fields and import raw materials to make import-substitutes instead of exports; and (iii) transfer of profit from FDI companies to their home countries starts increasing.

Besides transferring the profit, foreign-invested companies have to pay salary to hired experts, hired intellectual property, interest on loan capital and other expenses. Vietnam should consider the outflow as dynamic because the inflow will increase accordingly when the outflow increases. If investments in Vietnam are successful and profitable, net present value of the outflow will be bigger than that of the inflow.

d. Immigrant remittance:

To increase the immigrant remittance, Vietnam must expand markets for guest labor, and adopt active policies to encourage expatriates to put their money in businesses in Vietnam, and protect their property in Vietnam. Favorable conditions for use of official channels of remittances must be created by (i) facilitating delivery of money sent from abroad and allowing recipients to get foreign exchange easily as they want to; (ii) encouraging establishment of branches of Vietnamese banks in foreign countries; and (iii) studying regulations on money transfer in countries where the community of Vietnamese expatriates is big with a view to help them send their money home easily.

In short, in its effort to integrate into the world economy, Vietnam can hardly avoid effects of the global financial crisis, and the longer the crisis, the more profound these effects when Vietnam has to carry out commitments as required by the WTO.

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