The Impacts of Eurorean Debt Crisis On The Prospects Of Some Economic Areas In Vietnam

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INTRODUCTION

The European sovereign debt crisis is an ongoing financial crisis started in Europe from 2010 as the borrowing costs of the governments' debts kept on rising. It's unclear now that when the crisis will go to an end, as we haven't seen any effective measure to solve the crisis completely.

As EU is an important economic partner of Vietnam, the bad developments of EU economy such as sovereign debt crisis will have strong effects on Vietnam economy through main channels including: (i) Negative impacts on the world economy, as well as on US, Japan and China's economy as Vietnam's vital economic partners; (ii) Impacts on the structure of export and import between Vietnam and EU; (iii) Impacts on capital flows to Vietnam including FDI, ODA and remittance; and (iv) Impacts on commodity and service prices in Vietnam.

1. Impacts on the world economic prospects

Lasting for nearly 3 years the debt crisis hasn't ended and caused huge impacts not only on the European region but also on the world economy. Because of the crisis, most European countries have implemented austerity policies which resulted in the decline in most economic activities (production, investment, export and employment) and the financial market instabilities, which in turn resulted in European economic stagnation or recession. Moreover, austerity policies were also the cause of political instabilities in these economies.

Besides, European debt crisis also has large impacts on the world economy. As one of the biggest economies in the world, the serious decline in production and import demand from Europe led to the decline in production, export and investment activities, which in turn resulted in the declined commodity prices and increased unemployment in most economies, including important economic partners of the Europe such as US, Japan, China and large export-orientated emerging economies. According to many international organizations, the debt crisis is forecasted to continue to be the biggest danger of global economic prospects in the medium term.

As Vietnam has integrated more and more widely and deeply in the world economy, the world economic outlook in general and that of the Europe in particular will have strong impacts on Vietnam's economic outlook.

2. Impacts on Vietnam's trade prospects

As an open and export-oriented economy, the debt crisis in Europe will have strong impacts on Vietnam's trade activities, particularly exports. Because EU is the second largest export market of Vietnam, the EU debt crisis will firstly have direct impacts on Vietnam's exporting activities to this market. Besides, significant decline in demand from EU, the most important target export market of the global supply chains, will affect trade activities of Vietnam's important trade partners in East Asia production network (including Japan, China, ASEAN, etc), and the demand for Vietnam'exporting products from those markets will be affected.

2.1 Vietnam's export and import situation and trends under the impacts of European debt crisis

Vietnam's trade with EU in recent years, which was impacted strongly by three important milestones, consisting of the Enterprise Law and Common Investment Law in 2005, the accession of Vietnam into WTO in 2007 and global financial crisis and economic recession in 2008-2009, has gained high growth rates and EU still maintained its position as an important exporting partner of Vietnam, while Vietnam's position in EU's market has also been improved. From 2006 to 2011, the share of Vietnam's goods in total EU's import goods increased from 0.5% to 0.8%, which helped Vietnam to improve its position from 35th largest EU's importing partners in 2006 to 30th in 2011. This share also increased to 0.9%, 0.9% and 1.2% respectively in Q1, Q2 and Q3 of 2012.

2.1.1 Vietnam's trade in goods with EU by content of production factor

Vietnam's import and export activities with EU in recent years have been affected slightly by the global financial crisis and economic recession. However, it has not been impacted much by the European debt crisis. Regarding import of goods, the European debt crisis may create opportunities for Vietnam because the prices of high-technology capital goods and intermediate goods tend to decrease, which help Vietnam's enterprises to improve their competitiveness by importing this commodity group.

Regarding the export of goods by content of production factor, Figure 1 shows that Vietnam's exports of goods to EU has increased strongly, particularly after Common Investment Law[1] (in 2005) and Vietnam's accession into WTO (2007). After sharp decline in 2009 due to the financial crisis, Vietnam's exports to EU has increased significantly due to increased exports of technology-intensive goods (chemical goods, electronics, instruments and aviation goods) thanks to large contribution from FDI enterprises.

For exports structure by factor content, Figure 2 shows that Vietnam's exports structure to EU saw much improvement. While in 2001 (one year after the Enterprise Law 2000 coming into effect), the group of labor-intensive goods accounted for a large proportion of 62% of Vietnam's exports to EU, this proportion reduced sharply to 55% in 2006 (one year after the Enterprise Law 2005 and the Common Investment Law coming into effect), 51% in 2008 (one year after Vietnam's accession into WTO) and 35% in 2011. Meanwhile, the share of technology-intensive goods group has been continuously improved – from 3% in 2001 to 6% in 2006, 8% in 2008 and 30% in 2011.

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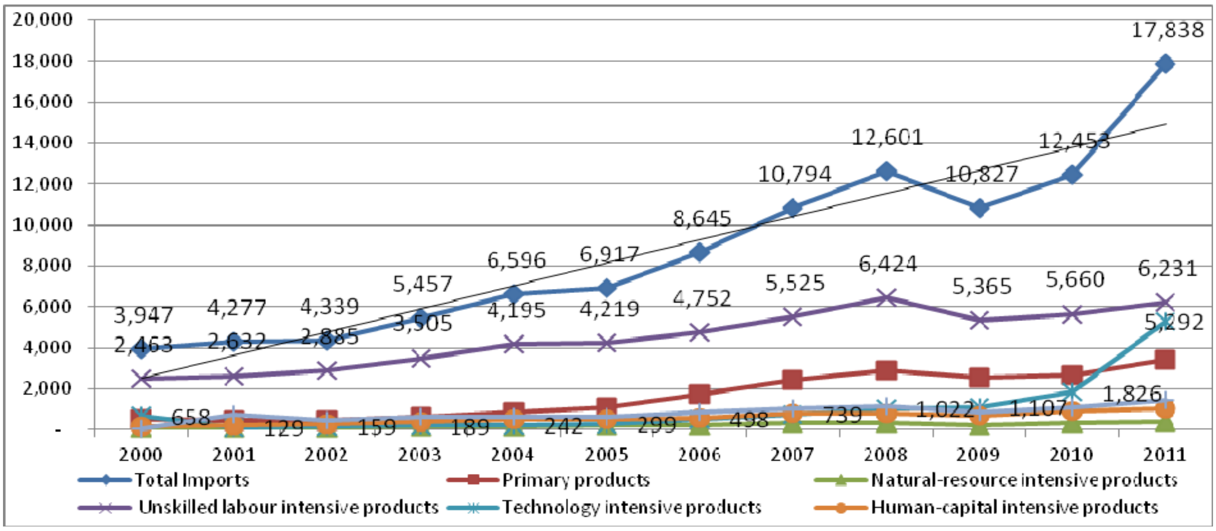
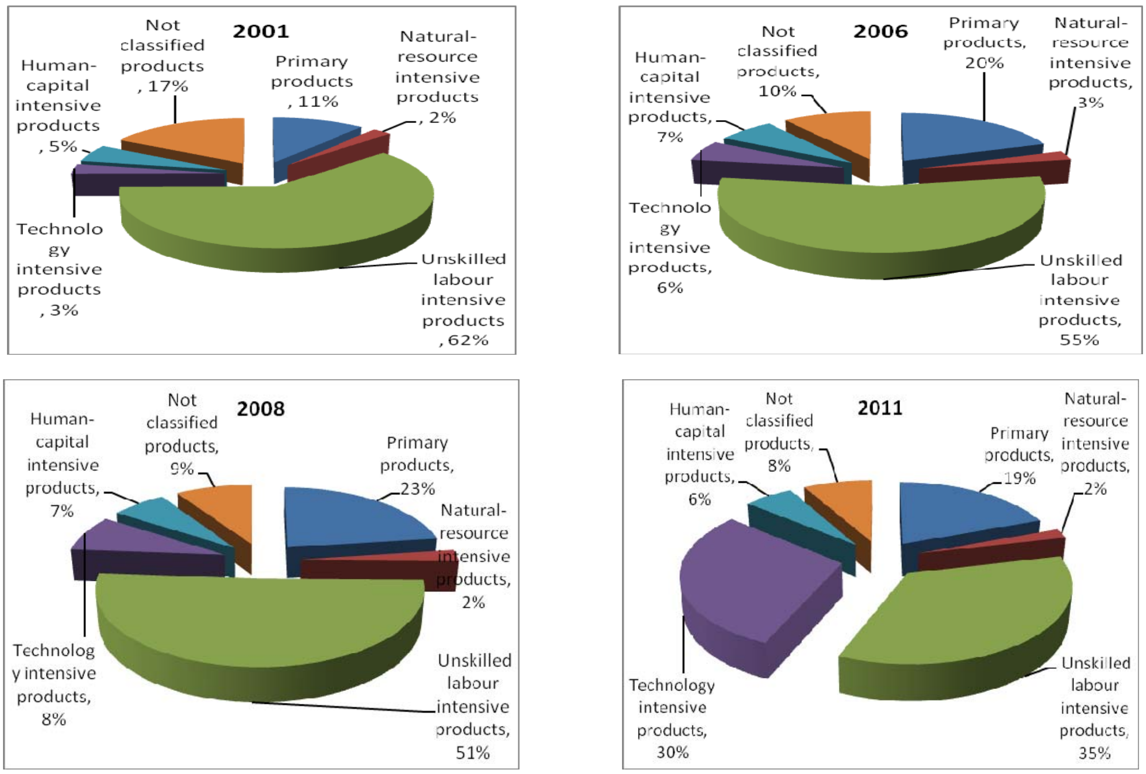
[1] Foreign Direct Investment (FDI) to Vietnam has increased strongly, explaining Vietnam's large export value which is contributed largely by FDI's enterprises sector.



Source: Calculations of Department of World Economy, National Centre for Socio-economic Information and Forecast (WED-NCEIF) according to UNCOMTRADE data on EU27 imports of goods from Vietnam by SITC 3.

Figure 1: Vietnam's goods exports to EU by factor content (million dollars)

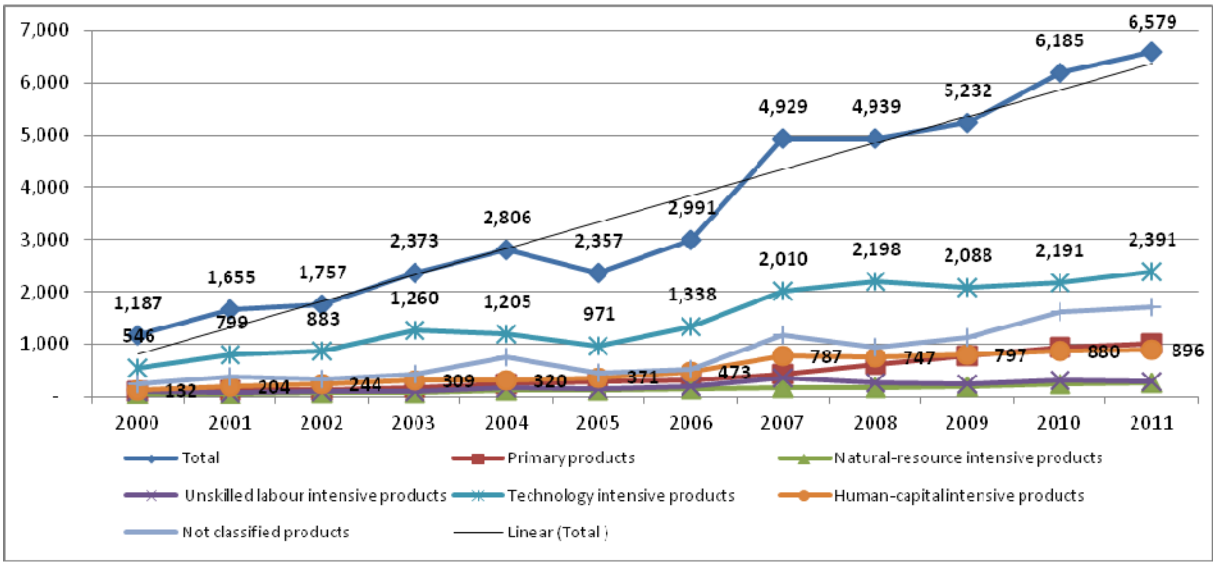


Source: Luong Van Khoi (2012).

Figure 2: Structure of Vietnam's exports of goods to EU by factor content

It can be seen that even when the European debt crisis became worse in 2010-2011, Vietnam's exports to EU still increased strongly, and the structure of Vietnam's exports of goods to EU has been more and more improved towards increasing the share of technology-intensive goods thanks to the contribution of FDI enterprises and Vietnam's cheap labor cost advantage against neighboring countries such as China which brought Vietnam the price advantage in finished products.

Regarding import of goods by factor content, Figure 3 shows that even in 2008 and 2009 when Vietnam was strongly affected by the global financial crisis, imports still increased due to increased imports of primary goods, natural resource-intensive goods and unclassified goods. Imports of technology-intensive and human-capital intensive goods decreased slightly in this period, however it increased strongly again in the following years.



Source: Calculations of WED-NCEIF according to UNCOMTRADE data on EU27 exports of goods to Vietnam by SITC 3.

Figure 3: Vietnam's imports of goods from EU by factor content (million dollars)

2.1.2 Trade supplementary level of Vietnam's products with EU

As mentioned above, Vietnam ranked 30th in EU's largest trade partners. In some product groups, the proportion of Vietnam' goods in EU's imports is more noticeable, such as leather and shoes products (group HS64-67, 11.9% in 2010), textiles (0.8%)-apparels (2.1%), agriculture products (mainly seafood and vegetable, 1.8%). With these advantage products, Vietnam's export products continued to maintain and gain higher trade supplementary level with EU market, from 38.265 in 2004 to 49.150 in 2009, and tends to catch up with the trade supplementary level of other main markets for Vietnam's merchandise export such as US or Japan (Table1).

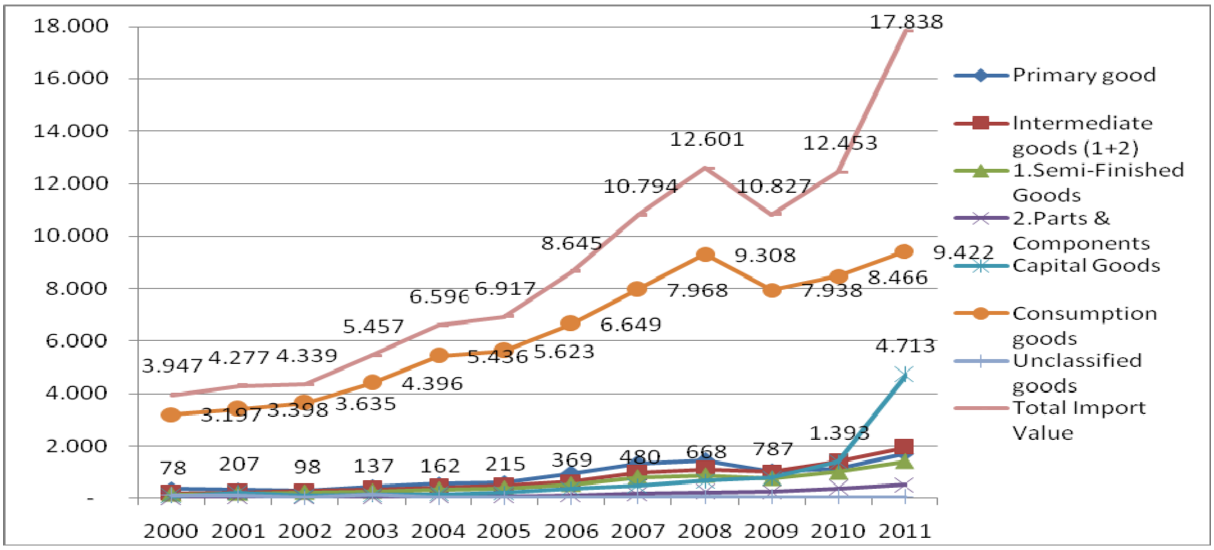
Table 1: Trade supplementary levels of Vietnam's export products with other trade partners

	2004	2005	2006	2007	2008	2009
With ASEAN	36.507	39.507	42.342	44.170	46.824	46.894
With China	29.642	30.891	34.178	35.589	41.536	36.370
With Korea	43.659	46.464	47.939	46.562	47.407	43.115
With Japan	51.260	54.103	56.639	55.599	56.683	53.250
With USA	44.125	46.458	49.385	51.783	53.220	51.778
With EU25	38.265	40.087	42.236	44.501	48.057	49.150

Source: Trương Đình Tuyển et.al (2011).

With this characteristic of Vietnam's exports, in the early period of European debt crisis (2010-2011), the weakening demand from EU did not really affect Vietnam's export activities. Vietnam' main products exported to EU were mostly cheap products and essential consumer products, and because of this they are the final products to be cut in European people's shopping list, and even became the substitutes for more expensive products.

In terms of end-use purpose, Vietnam's goods exports increased sharply in 2011 due to the increased exports of capital goods (from 1.393 billion USD in 2010 to 4.712 billion USD in 2011). Consumer goods also grew rather strongly (from 7.938 billion USD in 2010 to 8.436 billion in 2011), and continuously maintained its share of over 50% in Vietnam export value to EU (Figure 4). Because of this, Vietnam exports growth to EU increase sharply in 2010-2012, with the growth rate increasing from 23.3% in 2010 to 45.4% in 2011, much higher than Vietnam's average export growth rate (33.3% in 2011).



Source: Caculations of WED-NCEIF according to UNCOMTRADE data on EU 27 imports of goods from Vietnam by BEC code.

Figure 4: Vietnam goods exports to EU by end-use purpose (USD million)

However, since late 2011, when the EU debt crisis tended to be more serious and continuously weaken their purchasing power, the decline trend of Vietnam's exporting growth was more clearly. In 2012, growth of Vietnam's exports to EU market was only 22.5% compared to high growth in 2011. The decline of Vietnam main export products was more tremendous. The growth of Vietnam's textiles and apparels export products was negative (-2.7%) in the first half of 2012[2], seafood exports to EU market declined -12.7% in the first 7 months of 2012[3].

In contrast, the trade supplementary level of EU's export goods to Vietnam tended to increase gradually in recent years (from 62.524 in 2004 to 71.650 in 2009), and supported imports growth from EU to Vietnam. Table 2 compares the ability of foreign export products in meeting Vietnam's demand through trade supplementary index. Goods from EU better met Vietnam demand in 2004-2009. Suprisingly, EU25 has highest trade supplementary level, with the trade supplementary index increased alsmost continuously from 62.5 in 2004 to 65.0 in 2007 and 71.7 in 2009.

Table 2: Trade supplementary levels of goods exported from Vietnamese trade partners to Vietnam in the period of 2004-2009

	2004	2005	2006	2007	2008	2009
ASEAN	47.775	50.162	52.420	53.681	57.332	60.884
China	39.634	40.504	41.903	43.576	44.690	53.928
Korea	55.230	53.967	52.819	55.348	59.390	61.336
Japan	48.212	48.652	49.042	53.290	54.867	60.734
United States	41.053	43.351	43.493	42.819	42.121	40.549
EU25	62.524	62.796	62.502	65.038	65.990	71.650

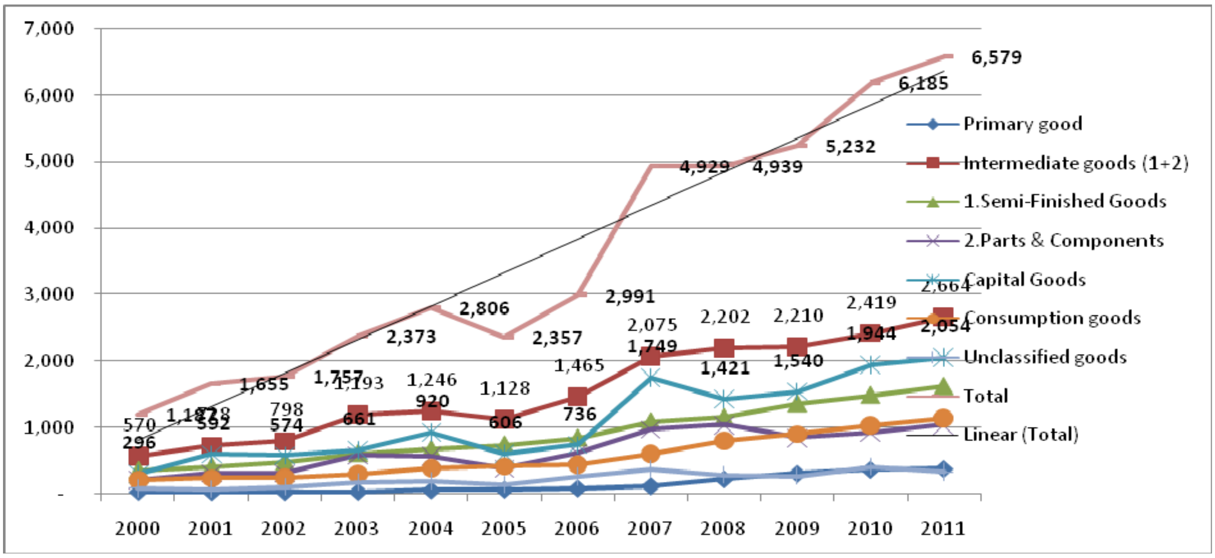
Source: Trương Đình Tuyển et al. (2011).

Regarding Vietnam's imports by end-use purpose from European countries, imports of imtermediate goods and capital goods were much higher than that of other groups, especially the consumer goods. In general, imports of both these two groups increased in recent years, even in the crisis period. Total imports of capital goods raised strongly in 2007, probably as a result of Vietnam's accession to WTO, which improved the FDI flows from European enterprises increased imports of capital goods (Figure 5).

Regarding total value of Vietnamese import goods from EU by end- use purpose, it can be seen that capital goods dominated a large proportion and showed the upward trend from 2006 (Figure 6), with the annual growth of 35.8% in 2001, 24.6% in 2006, 28.8% in 2008 and 31,2% in 2011. Additionally, the intermediate goods group account for the biggest proportion of 40%. However, the consumer goods accounted only 20% and increased modestly from 14.2% in 2001 to 17.4% in 2011.

This shows that the European sovereign debt crisis may have positive effects on the improvement of Vietnamese enterprises' competitiveness as these enterprises are equipped with high-tech capital goods at lower prices.

[2] According to the data of Vietnam textile and apparel Association (VITAS)
[3] According to data of Vietnam Association of seafood and exporter and producer (VASEP)



Source: Calculations of WED-NCEIF according to UNCOMTRADE data on EU 2 exports of goods to Vietnam by BEC code.

Figure 5: Vietnamese import goods from Europe by end-use purpose (USD million)

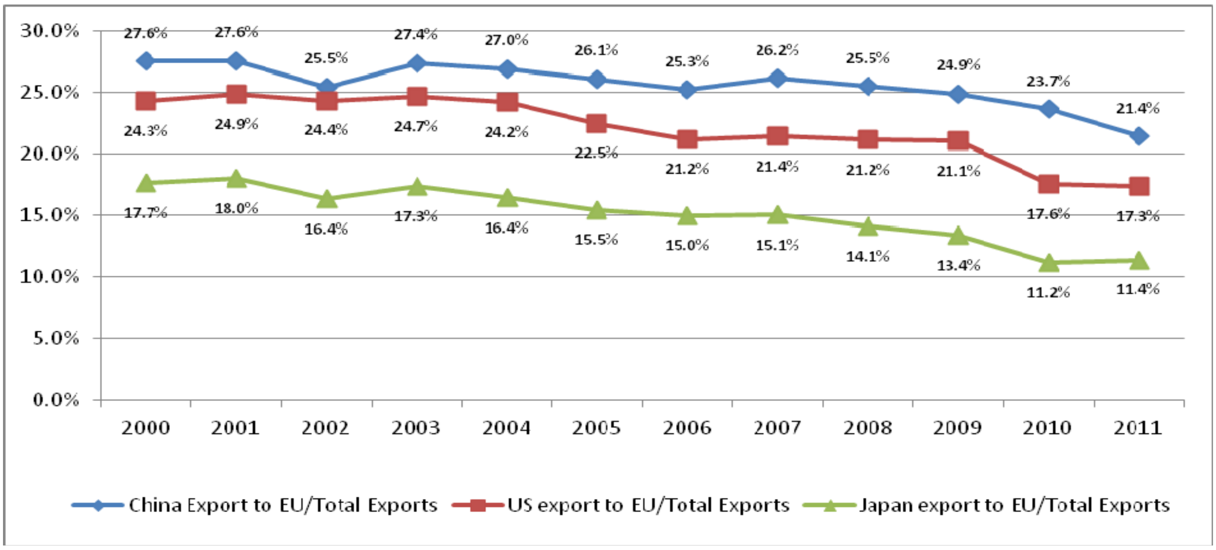
2.2. Impacts on world trade

The negative impacts of EU debt crisis on the world economy and other economies can be reflected clearly in trade of goods and services. While world trade in goods and services recoveried from the global crisis in 2009 with the growth rate of 12.8% in 2010, the EU debt crisis was one of the main reasons of another decline in world trade growth to 5.9% in 2011 and 2.8% in 2012 (IMF, 1/2013).

The important EU trading partners which were strongly affected by the EU debt crisis include US, China and Japan, as these three countries together accounted for more than 30% of total EU's trade. Because of this, if EU economies are further weakend by the impact of EU debt crisis, these three main trading partners will face a lot of difficulties. According to NCEIF, about 20% of total US export goods are exported to EU, in which up to 14% are exported to the Eurozone. Although the US's exports of goods to EU declined in 2009 and 2010 and improved slightly in 2011 (Figure 6), the share of US export to EU in total US exports tended to declined significantly, especially during global financial crisis and economic recession and recent EU sovereign debt crisis (Figure 6). Although the goods exported from China to EU accounted for the largest share, its growth rate has declined.

As the EU soveregin debt crisis has been worsening, the austerity policies will be maintained in the next years. This will affect the main export products of those countries to EU.

It can be seen that, the EU sovereign debt crisis has a large impact on trade prospects of those countries, which in turn affect their economic prospects. The less optimistic or declined economic growth rates of US, China and Japan's economies in turn will have certain impacts on Vietnam economy because these are the large import and export markets of Vietnam. Regarding China, the decline of external demand, especially demand from EU for their goods will affect Vietnam economic negatively. Firstly, the



Source: Calculations of WED -NCEIF based on UNCOMTRADE data.

Figure 6: The proportion of goods exported from US, China and Japan to EU in total exports of goods from those countries

structure of China's merchandise export is similar to Vietnam, so the competition pressure for their export goods is large. Because of this, if the demand from EU decline, Chinese companies will apply price cutting strategy to maintain their market share and put Vietnamese companies in higher competition pressure in export markets. Secondly, because the external demand declines sharply, Chinese domestic stock of finished goods will be large, and their enterprises will try to export these goods to Vietnam. As a result, Vietnamese enterprises could lose their competitiveness in the home market because Chinese products have larger advantages in terms of price and design. Thirdly, as Chinese domestic economy faces difficulty, their government will likely put the job creation priority on top. As a result, they will likely support their enterprises to invest in neighbor countries, including Vietnam, and bring Chinese workers to Vietnam as well, which will put Vietnam's job market in a worse position.

Briefly, Vietnam economy has and will have been sufferred sharply by historical international financial crisis and economic recession, and current debt crisis. The world economic prospects are less optimistic in this year and the following year due to the consequences of those crisis and current debt crisis. Vietnam economic growth in 2012 was only 5.03%, lower than 5.89% of 2011 and even lower and 5.32% in 2009, and is the lowest growth in past 10 years. Because the world demand declined, the stock of finished goods of Vietnamese enterprises increased sharply, and enterprises faced a lot of problems with increasing number of enterprises suffering from bankcruptcy, shuting down and perfunctory operation.

3. Impacts of European Debt Crisis on Prospects of Investment Capital Flows to Vietnam

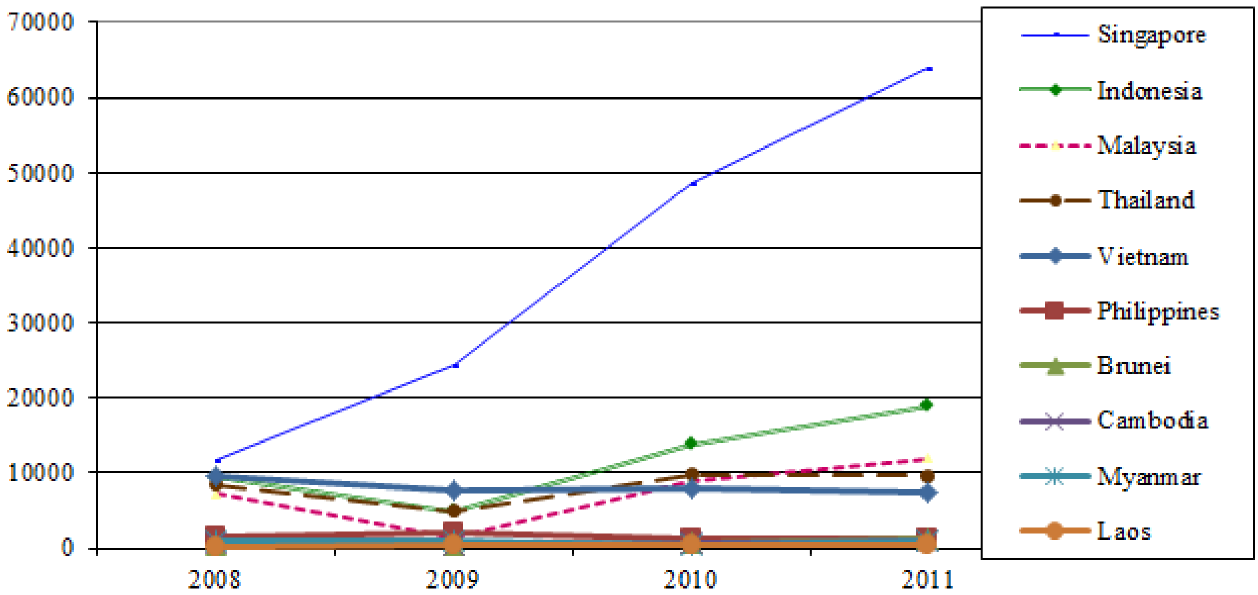
Vietnam's capital flows has been suffered strongly from European debt crisis in recent years and this effects will be maintaine in the next few years as the global capital flows is projected to recover slowly. European debt crisis spread to Vietnam investment capital flows mainly through the following channels:

(1) Foreign Direct Investment (FDI)

As Europe is a big investor in Vietnam, the debt crisis which undermined European economies will have strong effects on FDI flows to Vietnam. The share of European FDI in Vietnam decreased from 18% of total registered FDI in Vietnam in 2009 ($21.48 billion) to 11% of total ($14.7 billion) in 2011. This is equivalent to the decrease of over $2 billion on that period (from $3.86 billion to $1.6 billion). Besides, FDI inflows to Vietnam is facing some disadvantages due to deteriorated investment environment, including high inflation, weaken domestic currency, rising labor costs and more frequent strikes. Therefore, while other FDI inflows into other ASEAN economies benefited from better competitiveness against East Asian economies as these economies faced rising labor and production costs, Vietnam could not take this advantage. While FDI inflows to other ASEAN economies, according UNCTADSTAT, reached $117 billion in 2011, an 26% increase from 2010, FDI inflows to Vietnam declined from $8,000 million in 2010 to $7,430 in 2011.

The crisis may also hamper the prospects of FDI from Europe into Vietnam due to economic slow-down in EU economies. This also endangers the transfer of know-how and technology which is essential for Vietnam's medium and longer term growth and development. However, with the expected free trade agreement (FTA) between EU and Vietnam in the near future, this negative effect may be offset and a new wave of EU investors may appear in Vietnam after the FTA is signed.

Besides, the crisis will also affect FDI in Vietnam indirectly through its impacts on the global



Source: UNCTADSTAT

Figure 7: FDI inflows into ASEAN countries in 2008-2011 (million dollars)

FDI prospects. Global FDI flows, after recovering strongly in 2011 to $1.6 trillion, has decreased strongly to $1.3 trillion in 2012 due to escalating debt crisis. If the debt crisis in Europe intensifies and lead to another financial global crisis, the prospect of global FDI flows would beaffected much more seriously. Considering risks to global FDI flows, particularly debt crisis in Europe, UNCTAD (1/2013) forecasted that FDI flows could rise moderately to US$1.4 trillion in 2013 and US$1.6 trillion in 2014. Because of this, Vietnam need improve its investment environment strongly to prevent further decline in FDI inflows.

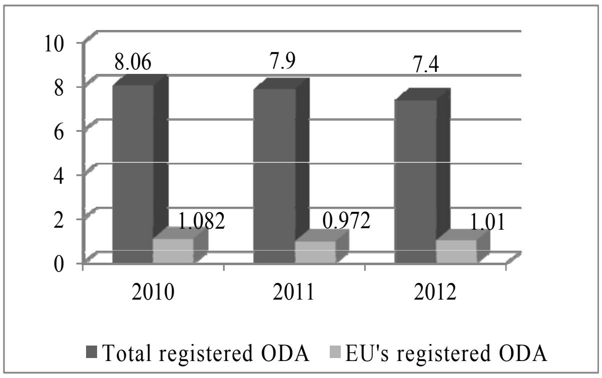
(2) Official Development Assistance (ODA)

Fiscal consolidation plans have forced European governments to cut spending, including ODA to developing and least developed countries. In 2012, UK announced the biggest cuts in budget spending since World War II (£83 billion by 2014-15). In France, there are plans to cut spending by €45 billion; and in Germany there was unveiled drastic public spending cuts of more than €80 billion. These cuts might lead to declines in aid to developing countries, adding to concerns in a context where several European countries were already struggling to meet aid targets after the global financial crisis. Latest reports of OECD indicated that ODA from DAC countries declined by 0.4% in 2012 following a shaper decrease of 3% in 2011 due to the European debt crisis [4]. OECD-DAC Survey on Donors' Forward Spending Plans for 2012 to 2015 suggest that bilateral aid from DAC members to developing countries will grow at a mere 2% over the period 2011–2013, compared to the average of 8% per year over the past three years.

[4] http://www.oecd.org/dac/stats/aidtopoorcountriesslipsf urtherasgovernmentstightenbudgets.htm

EU is a big ODA donor for Vietnam. Therefore, fiscal consolidation in EU countries will lead to the decline of EU's ODA for Vietnam in the future. ODA from the EU-15 fell -7.4% in 2012 compared to 2011 (OECD, 4/2013). Recently, UK has announced to stop providing ODA for Vietnam from 2016 as Vietnam has become a middle income country. However, it may partly be the results of fiscal consolidation plans of this country. EU's registered ODA for Vietnam has also dropped slightly from $1.082 billion in 2010 to $972 million in 2011 and $1.01 billion in 2012.

Besides, European debt crisis also affected ODA for Vietnam through its impacts on global ODA. As the crisis hampered the economies of other donor countries, the total registered ODA for Vietnam has also decreased from $8.06 billion in 2010 to $7.9 billion in 2011 and $7.4 billion in 2012.



Source: Ministry of Planning and Investment, R.S.of Vietnam.

Figure 8: Donor countries' registered ODA for Vietnam (*billion dollars*)

(3) Remittance flows

High unemployment rates associated to weak economic activity in developed countries because of the ongoing European debt crisis may translate into fewer remittances to developing countries in the coming years, which will lead to the decline of remittance flows to Vietnam. According to the

World Bank (2012), weak output and employment have dampened remittance outflows from major remittance senders in Europe such as the UK, Spain and Italy (Figure 9).

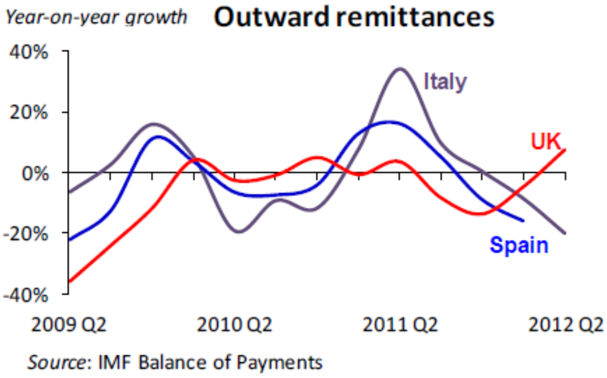


Figure 9: Weak remittance ouflows from Western Europe

The impacts of European debt crisis and sustained high unemployment rate in this area on remittance flows to Vietnam have been felt in 2012. The remittance flows to Vietnam was estimated by an official at State Bank branch in Hochiminh city to increase only slightly in 2012 to $9.2-9.5 billion. Remittance flows to Vietnam in 2012 mostly come from Taiwan, Japan, Malaysia and Korea, while remittance flows from US and Europe was very small. Moreover, the prospect of remittance flows to Vietnam in the coming years is questionable as total overseas workers in the first six months of 2012 declined by 6.248 people as compared with the same period in 2011.

4. Conclusions

As a small and open economy, the developments of word economy will have strong impacts on Vietnam economy. The European sovereign debt crisis has and will have negative impacts on world economic prospect in general through trade and capital flows.

Regarding trade sector, the European sovereign debt crisis had both positive and negative effects on Vietnam economy. In the period of 2010-2011, because of high trade supplementary characteristics of the Vietnamese and European markets, this crisis only affected modestly the Vietnamese- European foreign trade. However, entering 2012, the crisis tended to become worse which resulted in economic slowdown and other difficulties of the world economy as well as important economic partners of Vietnam, which had strong impacts on Vietnam economy in general and Vietnam's trade growth in particular.

Regarding the impacts of the European sovereign debt crisis on FDI, ODA and remittance flows to Vietnam, the decline of global FDI in 2012, the significant decline of European FDI in Vietnam and deteriorated investment environment of Vietnam were the reasons why FDI inflows to Vietnam decreased from 2008 to 2012. Besides, as EU is a big ODA donnor for Vietnam, the fiscal consolidation plans have forced European governments to cut spending will lead to the decline of EU's ODA for Vietnam in the future. Finally, the stagnant economic growth and high unemployment in Europe will also affect remittance flows from EU to Vietnam in the coming years.

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