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OPPORTUNITIES AND CHALLENGES FOR VIETNAM'S TEXTILE AND GARMENT EXPORTS IN TPP AND EU-VIETNAM FTA

Thuy NGUYEN[1]

ABSTRACT

The textile and garment industry has been a major export industry of Vietnam since it opened the economy in the mid-1980s. Both EU and TPP contracting parties are key export markets, accounting for more than two thirds of Vietnam's annual textile and garment exports. By signing the TPP and EVFTA, Vietnam will have greater access to expand its textile and garment exports to these traditional markets. However, textile and garment enterprises cannot enjoy duty preferences automatically, unless their products are qualified as "originating" under the agreements' rules of origin. Strategic investment promotion, administration procedures, and local enterprises' capacity building require further improvements, to take advantage of the opportunities and create more added value in the textile and garment industry.

VIETNAM'S TEXTILE AND GARMENT INDUSTRY

From the early stage of *Doi Moi*[2], the textile and garment industry has become the centre of Vietnam's manufacturing sector, creating jobs and contributing greatly to the country's export performance. The General Statistics Office shows that around 1.3 million people in the manufacturing labour force (approximately 25 per cent) are working in the textile and garment industry. Over the past two decades, the textile and garment industry has been the largest export manufacturing sector, until 2011 when it became the second largest behind electronics.

Globally, Vietnam's textile and garment industry always stands among the top ten largest exporters, accounting for approximately 3.6 per cent of the world's textile and garment exports in 2015. Major export markets for Vietnam's textile and garment products include, the USA (41 per cent), the European Union (EU) (15 per cent), Japan (15 per cent), and Korea (10 per cent). In the last five years, the export value of Vietnam's textile and garment industry has doubled, but the trading mode of the sector remains unchanged, maintaining a surplus in yarn and clothing, but a deficit for fibre and fabric. In particular, clothing (or garments) plays a dominant role, while the export of textiles (fabrics, yarns, fibres)[3] is quite modest.

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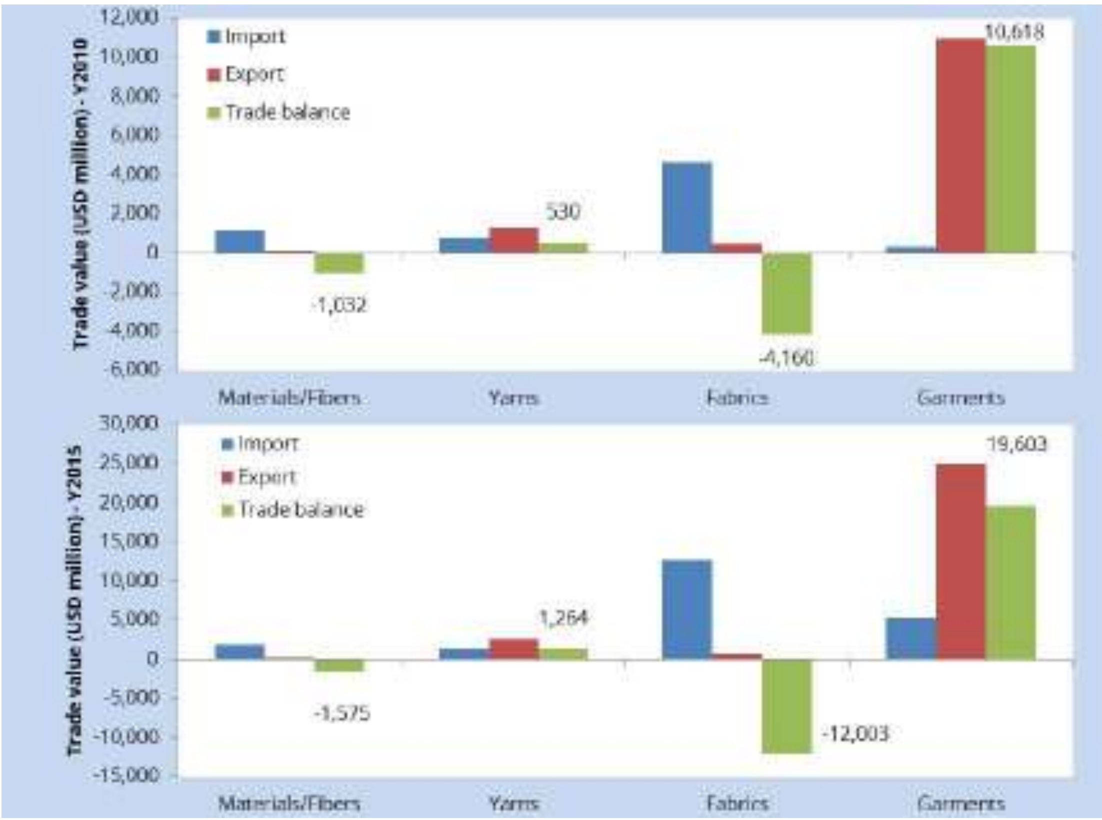
[1] **Thuy Nguyen** is a **Senior Research Fellow on Global Production Networks** at **International Economics Ltd.**

[2]Doi Moi (reform) is the name given to the economic reforms initiated in Vietnam in 1986 with the goal of shifting from a central planning economy to a "socialist-oriented market economy".

[3] In HS chapters, all items of textiles and garments are categorised in chapters 50 to 63. Of which, materials and fibres consist of HS codes 5001-03, 5101-05, 5201-03, 5301-05, and 5501-07; yarns include HS codes 5004-06, 5106-10, 5205-07, 5306-08, 5402-06, and 5510-11; fabrics include HS codes 5007, 5111-13, 5208-12, 5309-11, 5407-08, 5512-16, and 6001-6006; and clothing/garments are in chapters 61, 62, and 63.

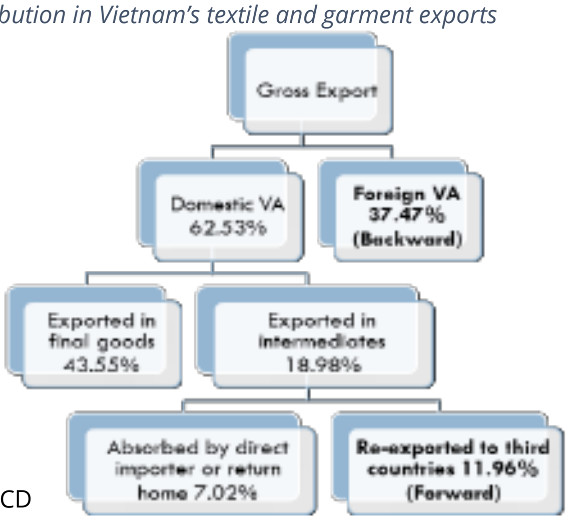
Figure 1 Vietnam's textile and garment exports, 2010-2015



Source: ITC TradeMap

The OECD's trade in value added (TiVA) database shows that gross exports of Vietnam's textiles and garments are composed of 62.5 per cent domestic value added, and 37.5 per cent foreign value added (FVA). For the domestic value added, 43.5 per cent was exported as final goods, 7 per cent was exported in intermediates absorbed by direct importers or returned home, and 12 per cent was used as inputs for exports to third countries (DVX). The data shows that the global value chain (GVC) participation of Vietnam's textile and garment sector is high, accounting for almost 50 per cent, but backward linkages are dominated by imports, with a FVA of 37.5 per cent, meaning that Vietnam's textile and garment exports depend largely upon the fabric and materials imported

Figure 2 Value distribution in Vietnam's textile and garment exports

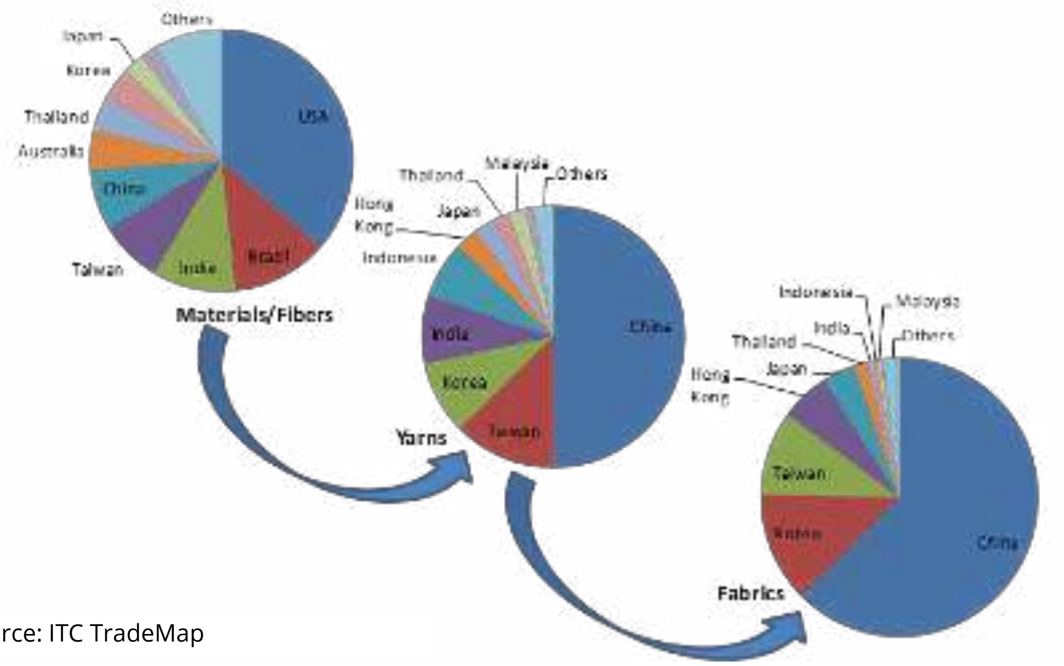


Source: OECD

from abroad, while the materials from Vietnam that are exported to other countries and used for export is still modest.

ITC statistics also show that the supply of materials for Vietnam's textile and garment industry depends largely on a single source, China, which dominates 50 per cent of the supply of yarns and fabrics for Vietnam. This is a disadvantage for Vietnam's textile and garment industry, for two reasons, (1) China is not a member of the Trans-Pacific Partnership (TPP); and (2) Chinese imports do not qualify under the EU-Vietnam Free Trade Agreement's (EVFTA's) rules of origin (RoO). As a result, and to take advantage of these new-generation agreements, the structure of exports and imports of textile and garment materials in Vietnam will have to change fundamentally in the near future.

Figure 3 Supply sources of textile and garment's materials for Vietnam, 2015



Source: ITC TradeMap

When considering textile and garments separately, the contrariety in the domestic textile and garment value chain is obvious. Among the more than 7,000 enterprises operating in the textile and garment sector, spinning enterprises account for only 1.8 per cent of the total, weaving enterprises account for 8.4 per cent, and 74.5 per cent are garment enterprises. Among garment enterprises, 70 per cent are CMT (cut, make, and trim), 25 per cent are able to purchase materials independently (FOB), only 4 per cent are able to develop their own designs (ODM), and just 1 per cent are able to develop their own brands (OBM). The imbalance in the number of businesses between textile and apparel, as well as the domination of CMT garment enterprises, implies that Vietnam's textile and garments sector is concentrating on the activities that create the lowest added value in the value chain, and only very few enterprises have the ability to perform activities that generate higher added value, such as branding, fashion, distribution system development, and marketing.

RULES OF ORIGIN ON TEXTILES AND GARMENTS UNDER TPP AND EVFTA

Rules of origin (RoO) are meant to ensure that only goods originating from FTA participating countries enjoy duty preferences. There are basically three methods to determine origin, namely the changing of the tariff clasification, value added, and the specific manufacturing process. In the TPP and EVFTA, all three methods are applied for textile and garment products.

Specifically, in the TPP, the provisions on RoO and regional value content (RVC) are specified in Chapters 3 and 4 of the Agreement. The items of textile materials under HS chapters 50 to 60 must meet the requirements of the change in tariff classification (CTC) at HS 4 or 6 digits. For clothing under HS chapters 61 to 63, to be qualified as originating and thus enjoy preferential tariffs, all three stages of spinning, weaving, and sewing must be done within the TPP (yarn-forward rules) countries. In addition to the general provisions above, the TPP also allows some exceptions. Some products are allowed to apply fabric-forward rules, such as traditional Japanese textiles. Some products are still considered to be TPP originating if one of the three stages is processed in any TPP country, such as suitcases, handbags, and children's clothing made from synthetic fibres. In addition, the TPP also accepts a short supply list (SSL), allowing member countries to buy the products in the list from non-TPP countries. This list includes 194 items, among which 8 items are valid for only five years after the TPP comes into effect, while the rest have unlimited validation. Furthermore, men and women's trousers made from cotton imported from the USA can apply exchange rules with the USA.

Compared with the TPP, the EVFTA has more relaxed fabric-forward rules, which require products in HS chapters from 61 to 63 to use woven fabric in Vietnam, or from the EU, or be of ASEAN or Korean origin (these countries have already signed FTAs with the EU). This is one stage less when compared with the provisions of the TPP (the spinning stage), but it would not eliminate the challenge for the domestic textile and garment industry, because as mentioned above, it is not spinning but weaving, dyeing and fabric finishing that are the weakest links in Vietnam's textile and garment industry.

OPPORTUNITIES AND CHALLENGES

By requiring specific manufacturing processes, the TPP and EVFTA provide opportunities for Vietnam to attract more investment to upstream activities, increasing domestic added value, and strengthening Vietnam's position in global textile and garment value chains. In the last five years, the textile and garment sector attracted 636 new foreign investment projects, with registered capital of more than USD 8.9 billion. Notably, investment in spinning and weaving increased rapidly from 13 projects with USD 0.4 billion in 2011, to 82 projects with USD 2.1 billion in 2015, and total registered capital over the last five years reached USD 6.3 billion, equivalent to 71 per cent of the total registered capital in the textile and garment industry. In addition, it is also expected that Vietnam's textile and garment businesses will take this opportunity to restructure their production networks and diversify their material sources, in order to improve their productivity and competitiveness.

However, opportunities and challenges are two sides of the same coin. The RoO in the TPP and EVFTA also bring about a number of challenges that require the attention of the relevant stakeholders. Firstly, the rules are actually barriers that not all local enterprises are able to overcome easily, since most of them are small and medium size, engaged only in the cutting/sewing process and highly dependent upon materials from non-TPP and non-EU sources. Secondly, whilst weaving, dyeing and finishing processes create high added value, they are technology and capital intensive, and also discharge large volumes of wastewater that can be harmful to the environment and people, unless the businesses involved implement social responsibility policy, installing environmentally-friendly equipment and technologies. Thirdly, a larger number of regulations on RoO in these FTAs compared to other FTAs, may lead to more complicated administrative procedures to certify origination, leading to further costs for textile and garment exporters.

IMPLICATIONS

Some implications emerge from the above analysis of Vietnam's textile and garment industry and the RoO in the TPP and EVFTA, including:

Firstly, institutional frameworks need to be strengthened for further trade facilitation, and consistent with the FTAs' commitments. The regulations of RoO in these FTAs are complicated and require a lot of documents to prove origin, thus the origin qualification may be costly and time consuming, which can affect an exporter's competitiveness. Developing online, one-stop procedures and services is needed to accelerate administrative reform.

Secondly, textile and garment business linkage services are necessary to connect separated players into supply chains to take up the opportunities of the FTAs. Rising wages, fiercer competition from lower wages countries, including Cambodia, Myanmar and Bangladesh, and stricter requirements of origin in textiles and garments, may cause a disadvantaged group being unable to compete in the textile and garment export market. On the one hand, these enterprises need to proactively restructure their activities to cut down production costs, improve productivity and competitiveness. On the other hand, the government support for capacity building is crucial to allow them to become more competitive and stay in the market, or prepare to move out and shift to other emerging industries.

A final consideration is the need for environmental impact assessments of new investments to prevent environmental pollutions. Specialised industrial zones for the textile and garment sector are needed, with installed concentrated wastewater treatment systems, which will play a critical role in reducing the investment cost to enterprises and controlling wastewater quality.

ABBREVIATIONS

ASEAN	Association of Southeast Asian Nations
CMT	Cut, Make and Trim
CTC	Change in Tariff Classification
DVX	Value added exports
EU	European Union
EVFTA	EU-Vietnam Free Trade Agreement
FOB	Free on Board
FTA	Free Trade Agreement
FVA	Foreign Value-Added
GVC	Global Value Chain
HS	Harmonised System
OBM	Original Brand Manufacturer
ODM	Original Design Manufacturer
OECD	Organisation for Economic Co-operation and Development
RoO	Rules of Origin
RVC	Regional Value Content
SSL	Short Supply List
TiVA	Trade in Value Added
TPP	Trans-Pacific Partnership
USA	United States of America
USD	United States Dollar
VA	Value Added

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In order to quantify the potential costs to your business in engaging in trade, including tariffs, standards, and customs procedures, among many others, we (i) undertake a mapping of which terms are most at risk of changing and by how much, depending on the type of agreements; and (ii) quantify and forecast the potential effect on your business using predictive analytics to generate insights into future outcomes.

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Contact Us:

Kerry O´Donoghue (Brussels)
Senior Manager
o.donoghue@tradeeconomics.com

Natalie Donikian (Mauritius)
Public Affairs Manager
donikian@tradeeconomics.com

@TradeEconomics
InternationalEconomicsLtd
trade-economics