VIETNAM'S INTERNATIONAL TRADE PERFORMANCE

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VIETNAM'S INTERNATIONAL TRADE PERFORMANCE

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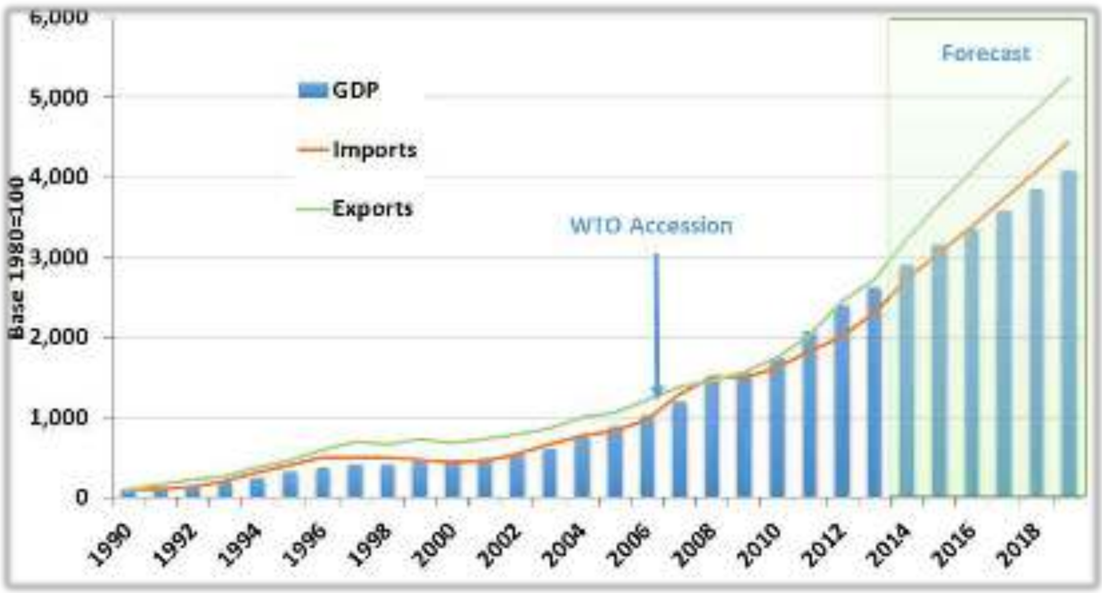
ABSTRACT

Vietnam's vertiginous economic growth since it started market reforms in the late 1980s has been driven by its external sector, as well as by high levels of FDI in export oriented sectors. Vietnam enjoys one of the highest trade propensity in the world and has strong complementarities with a number of large key markets. Its accession to the WTO and negotiation of a number of agreements within ASEAN and between ASEAN and other strategic regional partners have led to a more open trade regime with fewer restrictions in trade in services and investment. This article provides an insight into the areas where policy makers need to target their efforts in future trade agreements to better integrate Vietnam into virtuous levels of sustainable long-term growth.

VIETNAM'S PHENOMENAL ECONOMIC GROWTH

Vietnam's economy has sustained large levels of growth through capital accumulation and producitivity gains but the greatest contribution to growth has stemmed from international trade and investment flows. A near exponential growth in trade has been witnessed since Vietnam accessed to the WTO (see Figure 1).

Figure 1. Trade and GDP Growth in Vietnam (1990-2019)



Source: International Economics Ltd based on IMF WEO, April 2014

Overall exports have outstripped growth in imports, despite a period of worsening of the trade balance immediately in the aftermath of WTO accession. The rise in imports reflected the need for inputs into industries, greater demanded for imported technology and machinery, and an increase

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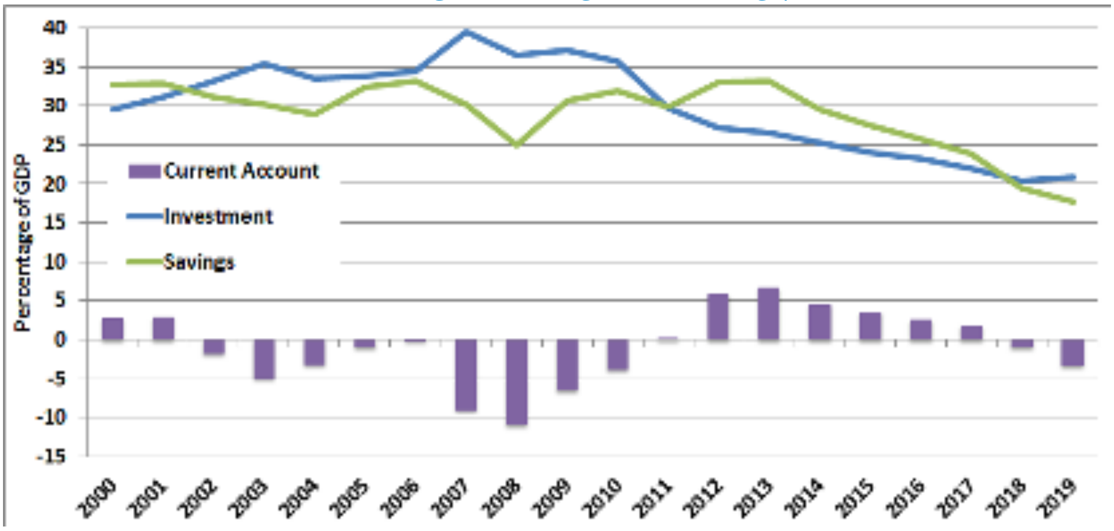
in the demand for consumption goods as per capita income rose in Vietnam. The increase in the trade deficit also reflected the deficit of savings to cover investment outlays in Vietnam (see

Figure 2).

Investment levels peaked at 40 per cent of GDP after accession and have subsequently fallen significantly, to close to 20 per cent of GDP, its lowest level since market reforms began in earnest. Despite the improvement registered on the current account deficit, which recorded a surplus for the first time in a decade. The low levels of investment are a cause for concern to policy makers. Investment in productive activities is needed for Vietnam to create long-term sustainable gains in per capita income. External capital will be required to cover the deficit in savings and the sources of such investment are likely to continue being Asian investment, and investment attracted by Vietnam's commitments in trade and investment agreements.

Figure 2. Savings - investment gap



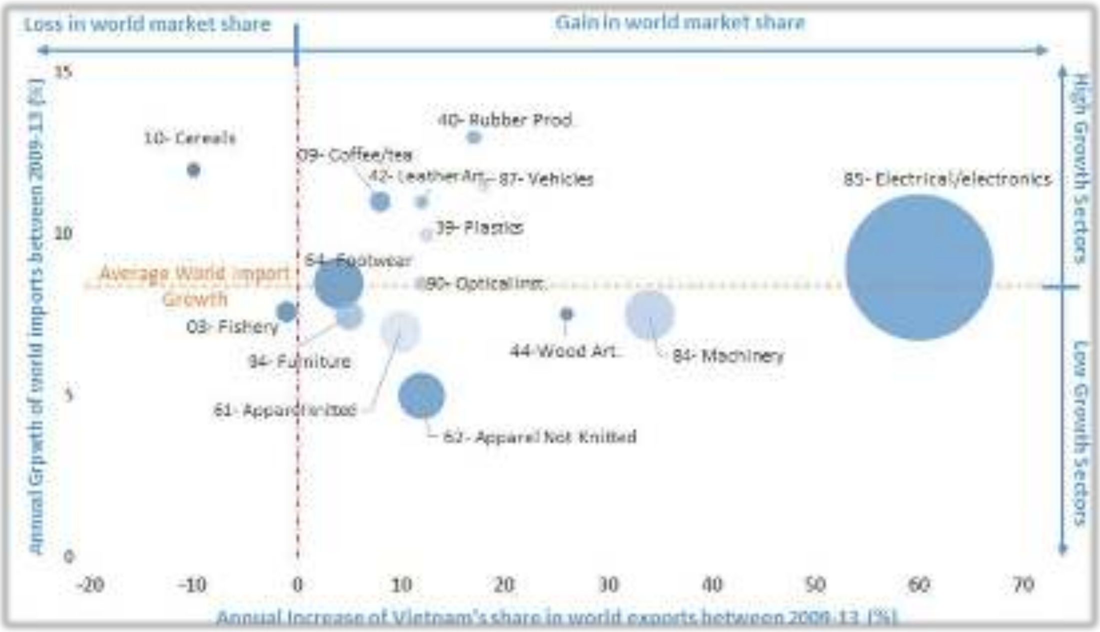
Note: 2014 onwards are forecasts Source: International Economics Ltd based on IMF WEO, April 2014

Vietnam's integration in the world economy has pulled its growth. Trade flows (imports and exports) amounted to 180 per cent of GDP, the seventh highest level in the world, and second only to Singapore and Hong Kong in South East Asia. Considering the size of the domestic market, and relatively well diversified economic structure, its outward orientation is remarkable.

Vietnam's export portfolio is relatively well diversified. It exports many high-tech products owing to foreign owned manufacturing operations based in Vietnam. Unprocessed exports also represent an important share in its export portoflio (mineral fuels, fisheries, coffee, wood articles), as well as some semi-processed goods (rubber, articles of iron, garments). For the great majority of products, Vietnam is increasing its world market share from agricultural commodities, to agro-processing to light manufacturing. Sophisticated technology intensive industries have emerged as dominant exporters (even if assembly operations dominate such activities in Vietnam). However, a number of the products which Vietnam exports are positioned in low growth segments, especially in the textile, wood articles and furniture sectors (see Figure 3).

Vietnam's export markets are relatively well diversified, even if the US (in apparel), China and Japan dominate its export shares. The EU market is its largest export market. Vietnam's main EU markets – Germany, Italy, Spain, France and The Netherlands did not experience strong growth (as benchmarked against world import growth of 6 per cent in the last five years), while the UK grew just above the benchmark. The most dynamic of its export markets have been South-East Asia, which grew at rates of 15 per cent or more per annum, while European markets are growing at less than 5 per cent per annum.

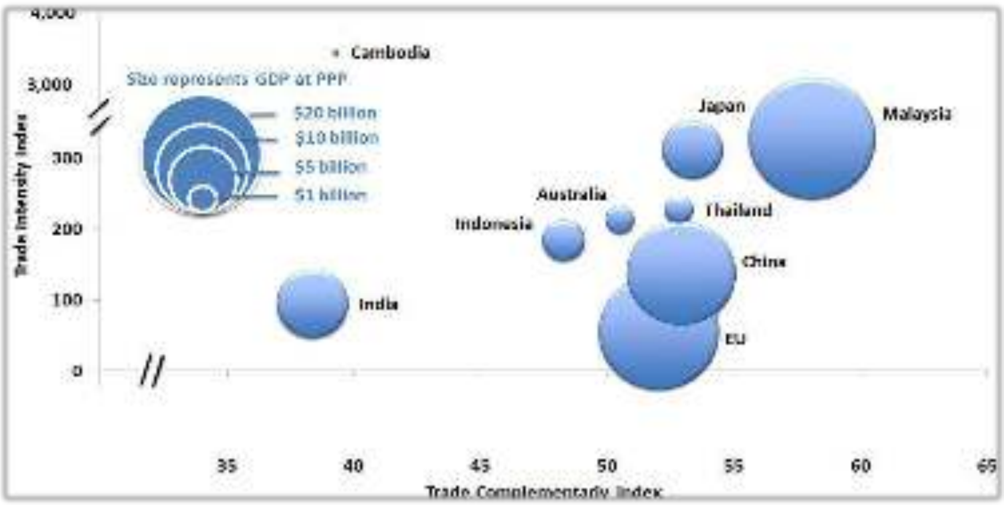
Figure 3. Vietnam's Export Portfolio in Terms of products, 2013



Source: International Economics Ltd based on ITC data

The degree of trade complementarity between Vietnam and the EU is quite high. Trade complementarity is defined as the match between the export supply from one country and the import demand of the other[2]. Trade complementarity is higher with the EU than some ASEAN countries, although it appears lower than with Japan or Malaysia. The trade complementarity and the degree of intensity of trade between Vietnam and selected partners is plotted in Figure 4.

Figure 4. Trade Complementarity and Intensity between Vietnam and the EU and Selected Economies



Source: International Economics Ltd

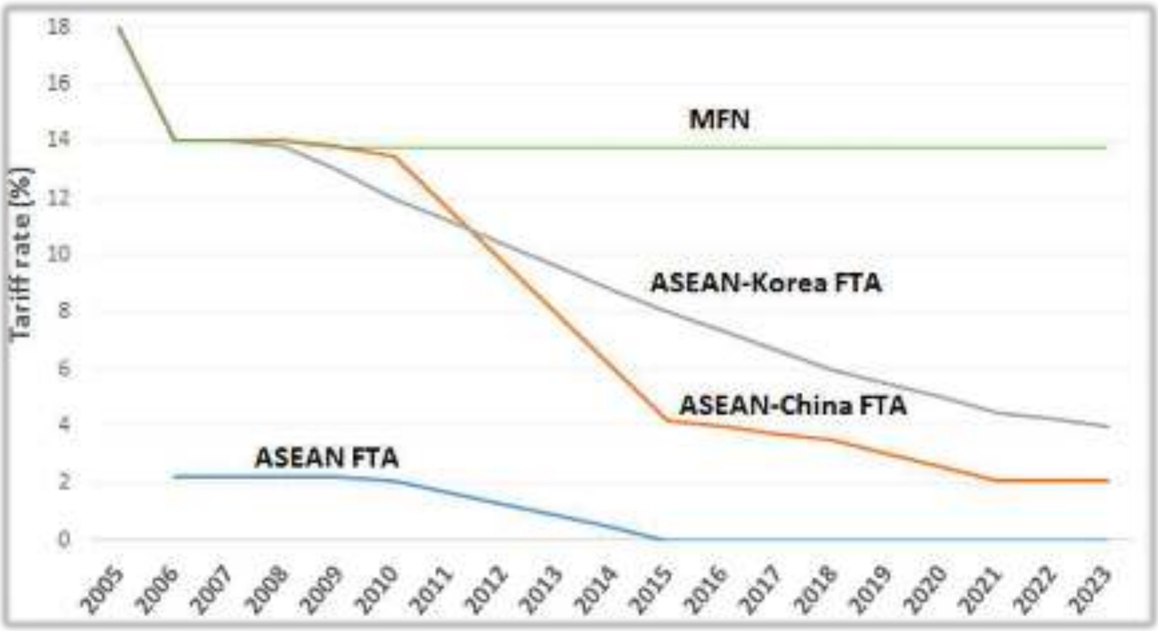
[2] The trade complementarity index is defined as $100\times\sum[x_{i,j} - m_{i,k}]/2$. X_{ij} represents exports from country j in sector i; m_{ik} represents imports of country k in sector i. 100 represents a perfect match (complementarity), while 0 represents no complementarity.

The level of trade intensity is measured by comparing Vietnam's trade with the selected partners, in comparison to the world trade intensity with these countries. If Vietnam trades proportionately more, then it is said to have a high level of trade intensity[3]. Vietnam has an extremely low level of trade intensity with the EU, particularly in comparison to other countries in the region which have lower trade complementarity. The results indicate that there may be opportunities to expand trade given the low levels of trade complementarity.

EXISTING TRADE RESTRICTIONS APPLIED BY VIETNAM

In its accession protocol to the WTO, Vietnam bound its tariff schedule mostly in the 0-40 per cent range. As a result, the simple average MFN tariff declined significantly, from 18.5 per cent in 2007 to 10.4 per cent in 2013. A few minor products retain tariff rate quotas, such as those relating to eggs, sugar, unmanufactured tobacco and tobacco refuse, and salt[4]. Beyond the WTO, Vietnam joined ASEAN in 1995 and is implementing the various ASEAN agreements in trade in goods (including sectoral working committees), services, and investment (see Article on the ACIA). Vietnam is also engaged in bilateral negotiations through ASEAN and has signed various bilateral agreements, whose tariff results are presented in Figure 5.

Figure 5. Tariff liberalisation under different agreements



Source: International Economics Ltd

Vietnam has generally committed to liberalise around 90 per cent of its trade and maintained full or partial restrictions on the other tariff lines. Vietnam applies a simple average MFN tariff of 9.5 per cent. The average for agricultural tariffs is 16.1 per cent, compared with 8.4 per cent for industrial goods. The peak tariffs are on alcohol and tobacco products, 100 per cent, and motor

[3] The Trade intensity index is defined as $(x_{ij}/X_{it})/(x_{wj}/X_{wt})$. Where x_{ij} and x_{wj} are the values of country *i*'s exports and of world exports to country *j* and where X_{it} and X_{wt} are country i's total exports and total world exports respectively. An index of more (less) than one indicates a bilateral trade flow that is larger (smaller) than expected, given the partner country's importance in world trade. For more information, see World Bank (2011) *WITS User's Manual*, Version 2.01.

[4] WTO (2013) *Trade Policy Review Vietnam*, Report by the Secretariat, WT/TPR/S/287, Geneva: WTO.

vehicles, especially motorcycles. Dairy products also face a significant tariff, as do some textiles. Since textiles are an input into apparel, removing these tariffs should make the garment industry more competitive.

The highest tariffs are generally clustered around processed agricultural products. Imports into Vietnam also face significant barriers on specific items, most notably on alcohol and tobacco products, around 100 per cent, and motor vehicles, especially motorcycles. Livestock products also face a significant tariff, as do some textiles[5]. Despite relatively low tariffs, there are a number of measures applied by Vietnam which restrict trade and investment in one form or another. These behind the border restrictions, which include non-tariff measures related to SPS or norms and standards to export restrictions and the like, are reported to be quite low in Vietnam. Vietnam has a few reported NTMs, concentrated on the application of tariff measures and export taxes.

In the field of services, as reported by the business community. Vietnam applies restrictions in mode 4 and few restrictions in other modes. Vietnam maintains significant restrictions on mode 3 (the right of establishment) mainly through the requirement of joint ventures with a majority share for the Vietnamese party (see Table 1).

Table 1. Service Restrictions applied by Vietnam

Vietnam	Overall	Mode 1	Mode 3	Mode 4
Financial	◑	◑	◑	...
Telecommunications	◑	...	◑	...
Retail	◑	...	◑	...
Professional	◔	○	○	◕

Note: ○ Open ◔ Mostly open with minor restrictions ◑ Major restrictions ◕ Virtually closed with limited opportunities to enter and operate ● Fully closed; Mode 1 refers to cross-border supply of services; Mode 3 refers to the right of establishment; mode 4 refers to the movement of

Source: World Bank (2014) *Service Trade Restrictiveness Database*, 15 February

The major restrictions applied by Vietnam in service trade seem to be in water transport. This includes coastal shipping, land transport and communications.

BACKWARD AND FORWARD INTEGRATION IN GLOBAL VALUE CHAINS

Vietnam is a country with a high degree of dependence on foreign inputs for export ability. This high propensity to import in order to export reflects Vietnam's dependence on external suppliers since it cannot easily source these locally, and is also an indication of Vietnam's participation in international supply chains. Exports from the textiles and apparel sector have a relatively low level of value addition (just over 20 per cent), of which only around one third originates domestically[6] (see **Error! Reference source not found.**).

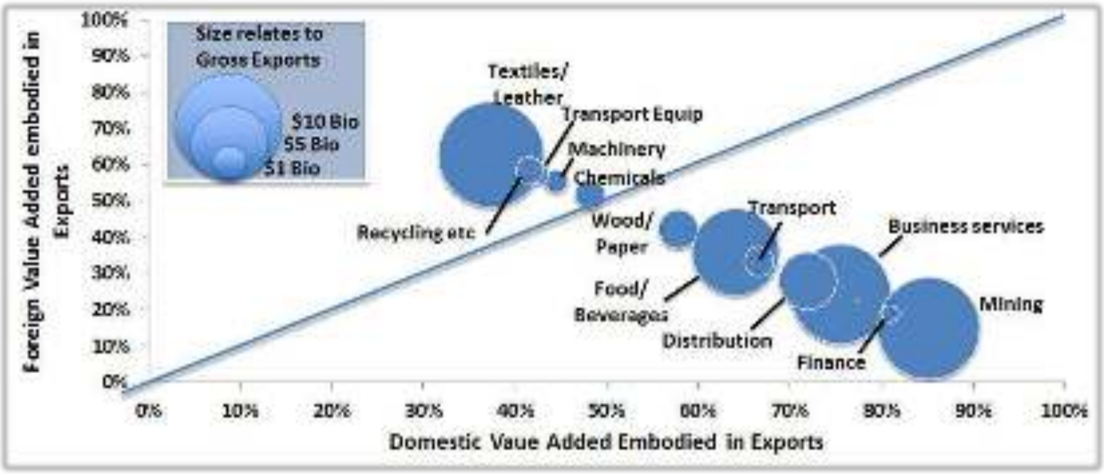
Other sectors, such as agriculture and agro-processing have overall even lower levels of value addition, although the level of domestic value addition is higher. Not surprisingly, Vietnam has the highest levels of value addition in the services sectors.

POLICY IMPLICATIONS AND OPTIONS FOR VIETNAM

Vietnam's market reforms which began nearly three decades ago have seen Vietnam become one of the most open economies in the world. It has managed to remain competitive, broaden and diversify its export portfolio and leapfrog into high-technology manufacturing processes.

[5] Baker, P., Vanzetti, D. & P. T. Lan Huong *et al* (2014), Sustainable Impact Assessment EU-Vietnam FTA, MUTRAP, September.
[6] Value addition is obtained from input-output tables.

Figure 6. Foreign & domestic value addition embodied in Vietnam's exports



Source: International Economics Ltd based on World Bank (2014) WDI and OECD (2014) TiVA Databases

Despite the successes, Vietnam has not managed to attract higher value added operations and remains an assembly base for multinationals in the region. Attempts to increase domestic content requirements go against both its WTO commitments and those undertaken in the context of ASEAN. Vietnam will need to create a more innovative environment, enforce stronger intellectual property rights and invest in research and development if it is to leapfrog into a new paradigm of higher value added production processes. The negotiation of new trade agreements, particularly those which are currently being negotiated with the EU and the Trans-Pacific Partnership (TPP) will need to ensure that it can fully benefit from the agreements as opposed to being confined to an assembly role for FDI. This will require careful crafting of language in such areas as the rules of origin and geographical indication, intellectual property rights, mutual recognition agreements and technology cooperation.

ABBREVIATIONS

ACIA	ASEAN Comprehensive Investment Agreement	**GATS**	General Agreement on Trade in Services
AIA	ASEAN Investment Area	**MFN**	Most-Favoured Nation
ASEAN	Association of South-East Asian Nations	**NTM**	Non-Tariff Measure
BIT	Bilateral Investment Treaty	**NT**	National Treatment
BTA	Bilateral Trade Agreement	**SOE**	State Owned Enterprise
EC	European Commission	**TPP**	Trans-Pacific Partnership
EU	European Union	**TRIM**	Trade-Related Investment Measure
FDI	Foreign Direct Investment	**UNCTAD**	United Nations Conference on Trade and Development
FIE	Foreign Invested Enterprises	**WTO**	World Trade Organisation
FTA	Free Trade Agreement		

HOW CAN WE HELP?

Support C-level executives and boards to prepare for different challenges

International Economics can help facilitate internal discussions on strategy by providing technical insights, developing dashboards of key performance measurements, and giving advice to executive boards on building resilience to possible disruptions related to exogenous trade shocks, such as Brexit or Donald Trump's Presidency. We work closely with our clients to brainstorm and identify challenges and opportunities based on our professional experience.

Map market access

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.

Navigate through trade and investment agreements

With more than 400 trade agreements and 2,400 investment agreements already in place, *International Economics'* team is able to navigate through them, guiding and identifying which specific agreement will better suit the interests of our client. Additionally, we have developed optimization techniques, through the use of sophisticated rules and algorithms, to analyse the Free Trade Agreements (FTAs), which are growing in space, depth and complexity, in order to offer insights into investment and trade decisions. With increasing fragmentation of global production networks and the need for careful evaluation of supply chain risks, the tools developed by *International Economics* offer a solid foundation for the adoption of critical decisions by businesses.

Prepare briefings and strategic papers

Our clients need to prepare strategic position papers to assess the issues and prepare responses, whether it be internal restructuring, supply chain re-engineering or addressing policy risks. We assist our clients with short, impactful, and relevant position papers, including setting out the possible impacts of risks at different business levels (policy, financial, structural, etc.) and provide the latest thinking on the issues to date, based on a holistic economic framework.

Undertake a full economic and legal review of the trade and investment exposures to worldwide events

We conduct independent and objective reviews of the impact of different worldwide events on your business and industry. We use deep learning tools, large multi-country macro models and the latest unstructured data to offer insights into the risks, exposure assessments and likelihood of disruptions to supply chain. These provide our clients with a competitive advantage as they prepare mitigation strategies and leverage identified opportunities. We work with our clients to develop the right strategies and make breakthrough decisions.

Brexit: Help the private sector position itself during the UK's trade negotiations

Brexit will affect our clients' business strategies, supply chains, funding, tax positions, regulations, growth and opportunities. *International Economics* works with public affairs companies and specialized firms to offer the full range of trade-related technical support and advice to help companies position themselves and ensure that their interests are addressed in the negotiations.

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