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# The economic and social effects of the EU Free Trade Agreement with Vietnam

Vienna, July 2018

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**AUSTRIAN FOUNDATION FOR  
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## ABBREVIATIONS

|           |   |
|-----------|---|
| ACFTA     | ASEAN-China Free Trade Agreement                                      |
| ASC       | Aquaculture Stewardship Council                                       |
| ASEAN     | Association of Southeast Asian Nations                                |
| ASI       | Group of other Asian countries  |
| ATC       | Agreement on Textile and Clothing                                     |
| BAP       | Best Aquaculture Practices  |
| BIT       | Bilateral Investment Treaty   |
| BMZ       | Federal Ministry for Economic Cooperation and Development             |
| BV        | Business Visitor  |
| CARIFORUM | Forum of the Caribbean Group of African, Caribbean and Pacific States |
| CBA       | Collective Bargaining Agreement                                       |
| CETA      | Comprehensive Economic and Trade Agreement                            |
| CGE       | Computable General Equilibrium  |
| CHN       | China   |
| CLO       | Core Labor Standards  |
| CMEA      | Council for Mutual Economic Assistance                                |
| CMT       | Cut-Make-Trim   |
| CN8       | Combined Nomenclature (8 digits)                                      |
| CoC       | Codes of Conducts   |
| CSR       | Corporate Social Responsibility                                       |
| CSS       | Contractual Services Suppliers  |
| DAG       | Domestic Advisory Group   |
| DFQF      | Duty-free-Quota-free  |
| EAC       | East African Community  |
| EAEU      | Eurasian Economic Union   |
| EBA       | Everything but Arms   |
| EC        | European Commission   |
| ECI       | Economic Complexity Index   |
| EPAs      | Economic Partnership Agreements                                       |
| EU        | European Union  |
| EU-MUTRAP | European Trade Policy and Investment Support Programme                |
| EUR       | Euro  |
| EVFTA     | EU-Vietnam Free Trade Agreement                                       |

|           |   |
|-----------|---|
| FBO       | Farmer-based Organization                                     |
| FDA       | US Food and Drug Administration                               |
| FDI       | Foreign Direct Investment                                     |
| FoA       | Freedom of Association  |
| FOB       | Free on Board   |
| FSIS      | Food Safety and Inspection Service                            |
| FTA       | Free Trade Agreement  |
| GATT      | General Agreement on Tariffs and Trade                        |
| GDP       | Gross Domestic Product  |
| GER       | Germany   |
| GlobalGAP | Global Good Agriculture Practice                              |
| GPA       | Government Procurement Agreement                              |
| GSP       | Generalized System of Preferences                             |
| GTAP      | Global Trade Analysis Project                                 |
| GVC       | Global Value Chains   |
| ICS       | Investment Court System                                       |
| ICTs      | Intra-Corporate Transferees                                   |
| IEC       | International Electrotechnical Commission                     |
| IFC       | International Finance Corporation                             |
| ILO       | International Labor Organization                              |
| IPs       | Independent Professionals                                     |
| ISDS      | Investor to State Dispute Settlement                          |
| ISO       | International Organization for Standardization                |
| JPN       | Japan   |
| KOR       | South Korea   |
| LDC       | Least Developed Country                                       |
| LEAP      | Livelihood Empowerment against Poverty                        |
| MARD      | Ministry of Agriculture and Rural Development                 |
| MENA      | Middle East and Northern Africa                               |
| MFA       | Multi-Fibre Arrangement                                       |
| MFN       | Most Favoured Nation  |
| MOIT      | Vietnamese Ministry of Industry and Trade                     |
| MOLISA    | Ministry of Labor   |
| MRA       | Moisture Retention Agents                                     |
| NAFIQAD   | National Agro-Forestry-Fisheries Quality Assurance Department |

|        |  |
|--------|--|
| NGO    | Non-Governmental Organization                          |
| NIF    | Neighbourhood Investment Facility                      |
| NL     | Netherlands  |
| NTB    | Non-Tariff Barrier                                     |
| NTM    | Non-Tariff Measure                                     |
| OBM    | Original Brand Manufacturing                           |
| ODM    | Original Design Manufacturer                           |
| OECD   | Organization for Economic Co-operation and Development |
| OEM    | Original Equipment Manufacturer                        |
| ÖFSE   | Austrian Foundation for Development Research           |
| OHS    | Occupational Health and Safety                         |
| PCA    | Partnership and Co-operation Agreement                 |
| PCSD   | Policy Coherence for Sustainable Development           |
| RoO    | Rules of Origin  |
| ROW    | Rest of the World                                      |
| SMEs   | Small and Medium Enterprises                           |
| SOEs   | State-owned Enterprises                                |
| SPS    | Sanitary and Phytosanitary Standards                   |
| SSA    | Sub-Saharan Africa                                     |
| SUPA   | Sustainable Pangasius Supply Chain                     |
| T&A    | Textile and Apparel                                    |
| TBT    | Technical Barriers to Trade                            |
| TCE    | Trade Cost Equivalent                                  |
| TPP    | Trans-Pacific Partnership                              |
| TRQ    | Tariff Rate Quotas                                     |
| TSD    | Trade and Sustainable Development                      |
| TTIP   | Transatlantic Trade and Investment Partnership         |
| TUR    | Turkey   |
| UK     | United Kingdom   |
| UN     | United Nations   |
| UNCTAD | United Nations Conference on Trade and Development     |
| UNECE  | United Nations Economic Commission for Europe          |
| UNIDO  | United Nations Industrial Development Organization     |
| US     | United States  |
| USD    | US Dollar  |



|         |   |
|---------|---|
| USDA    | US Department for Agriculture           |
| VDN     | Vietnamese Dong                         |
| VGCL    | Vietnam General Confederation of Labour |
| VIE     | Vietnam                                 |
| VietGAP | Vietnamese Good Agriculture Practices   |
| VITAS   | Vietnam Textile and Apparel Association |
| VNCPCC  | Vietnam Cleaner Production Centre       |
| WTO     | World Trade Organization                |

## EXECUTIVE SUMMARY

The EU has recently concluded or is currently in the process of negotiating a number of bilateral free trade agreements with both industrialized countries, e.g. Japan, and developing as well as emerging economies. Negotiations with the latter group include Vietnam, where negotiations on the EU-Vietnam Free Trade Agreement (EVFTA) were formally concluded in December 2015. After finalizing the legal review of the text of the agreement, which is underway at the time of finalizing this report (July 2018), the agreement will then be submitted to the Council of Ministers for approval.

Based on the EU trade strategy “Trade for All. Towards a more responsible trade and investment policy”, published in October 2015, these so-called new generation bilateral trade agreements are deliberately designed as ‘deep and comprehensive’. In other words, while also targeting remaining traditional trade barriers, such as tariffs and quotas, above all they aim at tackling other issues that are deemed relevant for trade. Amongst these figure investment liberalization and protection, intellectual property rights, public procurement, competition law and state aid, as well as non-tariff-measures. The latter include SPS-standards, technical barriers to trade, but also sector regulation and administrative procedures. In addition, it is emphasized by the EU that sustainable development aspects, in particular as they relate to human rights, labor standards as well as environmental aspects also need to be integrated into modern trade policy.

Furthermore, in the case of trade negotiations with developing countries, the agreements should also take into account the specific situation and needs of these latter countries, so as to be complementary and supportive of their development priorities. In other words, adherence to the principle of policy coherence for sustainable development (PCSD), as recently defined by the UN Agenda 2030 for Sustainable Development and subsequently adopted by the new European Consensus on Development, is required. New generation FTAs are therefore primarily to be assessed against this yardstick, which is the approach adopted in this study with respect to the EU FTA with Vietnam.

The methodological approach of this report combines both quantitative and qualitative methods. While the economic assessment is based on simulations with the ÖFSE Global Trade Model, a structuralist Computable General Equilibrium model, the qualitative analysis on the agreement and its implementation challenges as well as the case studies draw on text and data analysis, a literature review and interviews in Vietnam. The interviews were conducted with diverse stakeholders from the government, the private sector and civil society, and complement other data sources used throughout the report (see a list of interviewees in Appendix). The sector case studies selected were focusing on important export-oriented industries of the partner country, whereby textiles & apparel as well as aquaculture with a focus on shrimp and pangasius production was investigated for Vietnam.

The **main findings and key policy recommendations** of the study can be summarized as follows:

### **1. Estimated economic effects of trade liberalization for Vietnam are positive:**

Vietnam has dynamically integrated into the world economy since the early 1990s and established a clear surplus in its trade balance with the EU of almost EUR 24 billion in 2016. While Vietnam enjoys already preferential market access to the EU via GSP and up to 24.5% of tariff lines enter the EU market duty and quota free (DFQF) (equivalent to 59%

of the EU import volume), the major export sectors, textile, apparel and footwear, will benefit significantly from the reduction of tariffs by the EU and bilateral exports in these sectors contribute strongly to positive export effects. The liberalization of import tariffs by Vietnam increases the inflow of goods from the EU by more than 7%, with only a limited number of sectors (motor vehicles, machinery and foods) being negatively affected with regard to declining output. For these individual sectors the impact may however be quite large which will require adjustment assistance to cushion negative effects, particularly given the importance of the food sector for the livelihood of farmers and consumers and the motor vehicles and machinery sectors for industrial development. In combination with positive effects on domestic real consumption, the positive impact on Vietnam's net exports to the EU leads to an increase in Vietnam's real GDP by 0.48%. Due to the incidence of trade impulses for in particular labor intensive sectors, the EVFTA will have a higher effect on employment, with an increase of 0.88% or around 450.000 jobs.

## **2. Public revenue losses will negatively affect Vietnam, but should not pose a particular policy challenge:**

In the case of developing and emerging countries, the effects of tariff liberalization on the public budget need to be carefully considered, as typically tariff revenue is an important component of public income. In the case of Vietnam, our model simulation however show that forgone tariffs will be rather low, accounting for 0.28% of GDP, which is not expected to lead to substantial fiscal policy challenges.

## **3. Promotion of export sectors needs pro-active policies for upgrading:**

Given that trade liberalization should positively contribute to growth and employment creation, a careful consideration of the potentials for increasing exports in selected sectors is important. On the basis of a detailed analysis of specific agri- and aquaculture sectors (pangasius/shrimp) as well as the textiles & apparel sector in Vietnam, our analysis points to the need for policy interventions in two priority areas:

1. *Export potentials for food products depend on investment in processing and branding activities and in quality infrastructure:* given that most GVCs for agricultural and food products are buyer-driven, increases in export revenues need an approach that aims at extracting more value-added from each unit exported. This is particularly the case, where further increases in export volume are constraint by production conditions, e.g. water scarcity, and/or lead to negative environmental externalities. Export-oriented upgrading activities, in particular processing of e.g. shrimp or fish into ready-to-eat products or production of bottled olive oil for final consumers, do not only need investment in processing facilities, but in particular marketing and branding strategies in order to gain access to retailers and become attractive to final consumers. Trade policy can support upgrading both by improving market access, e.g. by eliminating remaining tariffs and quotas, and furthermore, by supporting to meet standards, both public SPS and private standards of lead firm in GVCs, in particular quality standards and certifications for organic products.
2. *Promotion of upgrading and of the textile sector is of strategic importance in the apparel sector:* against the background of continuing preference erosion in the apparel sector as more countries are receiving preferential market access due to the proliferation of FTAs, reduced lead-times and the trend to fast fashion, the sustained competitiveness of the apparel sector in the future will not primarily rest on the availability of cheap labor and DFQF market access, but on the availability of a flexible and high-quality production system that extends from the production of yarns and fabrics, the

availability of accessories and finishing services to modern logistics and transport services. Apparel production in Vietnam should thus increase its efforts to position themselves as a more developed apparel supplier, extending their role from CMT production and lower value products to increasing local value-added and linkages. This will involve investments in the build-up of a domestic textile sector, but also extend to other supporting services, e.g. increasing the availability of working capital for FOB production and productive investment credits as well as improving the technical skills of T&A workers.

#### **4. Trade policy should be policy-coherent for sustainable development and context-specific**

Sustainable development as defined by the UN Agenda 2030 and adopted by the European Consensus on Development, calls for the promotion of sustainable economic growth that is socially inclusive, respects ecological boundaries and promotes peace and democracy. Trade liberalization should thus be considered as a means to achieve the objective of sustainable development. Due to different geographical conditions, economic structures, political and institutional systems, trade liberalization outcomes for individual countries are however variegated, and it cannot be taken for granted that effects are exclusively beneficial, neither at the aggregate nor sectoral level. Thus, any approach to trade policy in compliance with the principle of policy coherence for sustainable development must take the specificities of a partner country systematically into account and adapt trade policy measures accordingly. The Sustainability Chapters are an important step forward in this regard but they need to be mainstreamed throughout the chapters of the core agreement. Further, where these chapters already exist such as in the case of the EU-Vietnam FTA, their formulation is rather weak and the political interest to implement them and fund the necessary dialogue processes has been weak on both sides.

Also, Vietnam is currently on an important transition point with pro-economic reformers and China-oriented conservatives struggling about the economic and political future of the country. Trade agreements play an important role in this broader transformation process as they are used particularly by pro-reformers to support national liberalization agendas as well as by NGOs to push for labor rights particularly in the context of the Sustainability Chapter. Strong political will on the side of the EU is thus necessary to support the effective implementation of the Sustainability chapter of EVFTA.

## ZUSAMMENFASSUNG

Die EU hat in letzter Zeit oder verhandelt derzeit eine Reihe von bilateralen Freihandelsabkommen sowohl mit Industrieländern wie zum Beispiel Japan, als auch mit Entwicklungs- und Schwellenländern. Zu letzterer Gruppe gehören Vietnam, mit dem die Verhandlungen über EU-Vietnam Freihandelsabkommen (EVFTA) im Dezember 2015 abgeschlossen wurden. Nach Abschluss der juristischen Prüfung des Abkommenstexts, welche zum Zeitpunkt der Fertigstellung dieses Forschungsberichts (Juli 2018) stattfindet, wird das Abkommen dann dem Rat zur Genehmigung vorgelegt werden und der weitere Ratifizierungsprozess durchgeführt werden.

Auf Grundlage der EU Handelsstrategie „Handel für alle. Hin zu einer verantwortungsbewussteren Handels- und Investitionspolitik“ von Oktober 2015, sind diese sogenannten bilateralen Handelsabkommen der neuen Generation bewusst als „tief und umfassend“ konzipiert. So sollen sie neben dem Abbau traditioneller Handelsbarrieren, wie etwa Zöllen und Quoten, vor allem andere handelsrelevante Themen in den Fokus nehmen. Zu diesen gehören Investitionsliberalisierung und -schutz, geistige Eigentumsrechte, das öffentliche Beschaffungswesen, Wettbewerbs- und Beihilfenrecht, sowie die nicht-tarifären Handelshemmnisse. Zu Letzteren gehören sanitäre Standards bei Lebensmitteln (SPS), technische Bestimmungen, aber auch Sektorregulierungen und administrative Verfahren. Dazu kommen noch als wichtiges Element moderner Handelspolitik laut EU Aspekte nachhaltiger Entwicklung, insbesondere der Schutz und die Förderung der Menschenrechte, internationaler Arbeitsstandards und der Umweltschutz.

Im Hinblick auf Verhandlungen mit Entwicklungsländern, sollen die Abkommen auch die besondere Situation und die Bedürfnisse dieser Länder berücksichtigen, um damit einen Beitrag zur Umsetzung entwicklungspolitischen Zielsetzungen der jeweiligen Länder zu leisten. Darin kommt die Anwendung des Prinzips der Politikkohärenz für nachhaltige Entwicklung zum Ausdruck, wie es zuletzt von der UN Agenda 2030 für nachhaltige Entwicklung vorgegeben und von der EU im neuen Europäischen Konsens für die Entwicklungspolitik bekräftigt wurde. Die Einschätzung der Auswirkungen von Handelsabkommen der neuen Generation hat daher vor allem anhand dieses Referenzrahmens zu erfolgen, und diesem Ansatz folgt auch die vorliegende Studie im Hinblick auf das Abkommen zwischen der EU und Vietnam.

In methodischer Hinsicht kombiniert die vorliegende Studie quantitative mit qualitativen Ansätzen. Während die wirtschaftlichen Effekte der Handelsliberalisierung mit Hilfe von Simulationen mit dem ÖFSE Global Trade Model untersucht wurden, erfolgte die qualitative Untersuchung der Abkommen und der Herausforderungen in der Umsetzung in den untersuchten Ländern und Sektoren auf Basis einer Auswertung der Abkommenstexte, der wissenschaftlichen Sekundärliteratur, statistischer Daten sowie von Expert/inn/eninterviews in Vietnam. Die Interviews wurden mit Expert/inn/en aus Regierungseinrichtungen, dem Privatsektor, der Zivilgesellschaft und der Wissenschaft geführt und ergänzen damit die anderen Datenquellen, welche für die Studie verwendet wurden.

Die Fallstudien umfassen die exportorientierten Sektoren Textilien & Bekleidung sowie der Sektor Aquakultur mit den Schwerpunkten Garnelen und Pangasius.

Die Hauptergebnisse und wichtigsten Politikempfehlungen der Studie lassen sich in den folgenden Punkten zusammenfassen:

### **1. Die Effekte der Handelsliberalisierung für Vietnam sind insgesamt positiv:**

Die Integration von Vietnam in die Weltwirtschaft ist seit den frühen 1990er Jahren sehr dynamisch verlaufen. Das Land wies 2016 einen Handelsbilanzüberschuss gegenüber der EU von fast EUR 24 Mrd. aus. Obschon Vietnam bereits jetzt einen präferenziellen Marktzugang zur EU im Rahmen des APS aufweist und rund 24,5% der Zolllinien (bzw. 59% des EU-Importvolumens) zoll- und quotenfrei in die EU geliefert werden können, wird das Land deutlich von der weiteren Zollreduktion aufseiten der EU profitieren. Davon profitieren aufseiten Vietnams vor allem die exportstarken Sektoren wie Textilien und Bekleidung, oder Schuhe. Die Zollsenkungen aufseiten Vietnams werden die EU-Exporte in das Land um ca. 7% ansteigen lassen, und damit nur eine geringe Zahl von Sektoren in Vietnam, vor allem in den Bereichen Automobile, Maschinen und Lebensmittel hinsichtlich deren Outputs negativ betreffen. Für diese einzelnen Sektoren werden die Auswirkungen jedoch relativ groß sein, was die Notwendigkeit von Anpassungshilfe bedeutet, um die negativen Effekte abzufedern. Dies gilt insbesondere aufgrund der Bedeutung des Lebensmittelsektors für den Lebensunterhalt der Bauern/Bäuerinnen und Verbraucher/innen sowie des Automobil- und Maschinensektors für die industrielle Entwicklung. Im Zusammenwirken mit positiven realen Konsumeffekten wird der Zuwachs im Außenhandel zur EU zu einer Zunahme des vietnamesischen BIP um 0,48% führen. Aufgrund des Umstands, dass die positiven Handelseffekte vor allem in arbeitsintensiven Industrien auftreten, wird das EVFTA einen größeren Effekt auf die Beschäftigung haben, mit einer prognostizierten Zunahme von 0,88% oder 450.000.

### **2. Der Verlust öffentlicher Einnahmen wird Vietnam zwar negativ treffen, sollte aber keine nennenswerte fiskalpolitische Herausforderung darstellen:**

Im Fall von Entwicklungsländern müssen die Auswirkungen von Zollsenkungen auf den öffentlichen Haushalt berücksichtigt werden. Zölle stellen in diesen Ländern in der Regel eine wichtige Komponente der öffentlichen Einnahmen dar. Im Falle Vietnams sind die erwarteten Verluste aus der Abschaffung der Zölle mit 0,28% des BIPs aber relativ gering und sollten demnach zu keiner grundlegenden fiskalpolitischen Herausforderung führen.

### **3. Die Förderung von Exportsektoren braucht aktive Politiken für Upgrading:**

Zur Förderung von Wachstum und Beschäftigung im Kontext von Handelsliberalisierung ist es wichtig, die Möglichkeiten zur Steigerung der Exporte in ausgewählten Sektoren in den Blick zu nehmen. Auf Basis einer vergleichenden Untersuchung bestimmter Aquakultur-Sektoren (Garnelen und Pangasius), sowie des für die Exportwirtschaft zentralen Textil & Bekleidungssektor verweist unsere Untersuchung auf die Notwendigkeit wirtschaftspolitischer Interventionen in zwei prioritären Handlungsfeldern:

- a) *Exportpotenziale für Nahrungsmittel brauchen Investitionen in Weiterverarbeitung, Markenbildung und qualitative Infrastruktur:* Da die meisten globalen Wertschöpfungsketten für agrarische Produkte und Nahrungsmittel käufer-orientiert sind, braucht es einen Ansatz zur Erhöhung von Exportumsätzen, der darauf abzielt, die Wertschöpfung pro exportierter Einheit zu steigern. Dies ist vor allem sinnvoll, wenn weitere Steigerungen von Exportmengen aufgrund der natürlichen Produktionsbedingungen, z.B. aufgrund von Wasserknappheit, nur beschränkt möglich sind, oder zu negativen Umweltauswirkungen beitragen. Export-orientierte Aktivitäten zur Steigerung der Wertschöpfung (upgrading), zum Beispiel im Bereich der Weiterverarbeitung von Garnelen oder Fisch zu Fertigprodukten für Endverbraucher/innen, benötigen jedoch nicht nur Investitionen in Produktionsstätten, sondern vor allem Marketing und Markenbildungsstrategien, um den Zugang zu Abnehmern zu finden und den Bekanntheitsgrad bei Endverbraucher/innen zu steigern. Die Handelspolitik



kann solche Upgradingprozesse unterstützen, sowohl durch erleichterten Marktzugang aufgrund der Reduktion von Zöllen und Quoten, als auch vor allem durch Unterstützung zur Erreichung sowohl von öffentlicher Gesundheits- und Hygienestandards als auch von privaten Standards und Zertifizierungen, etwa für biologische Produkte, wie sie von Abnehmern wie z.B. Supermärkten verlangt werden.

- b) *Die Förderung von Upgrading und der Textilproduktion ist von strategischer Bedeutung im Bekleidungssektor:* vor dem Hintergrund voranschreitender Präferenzerosion im Bekleidungssektor – indem immer mehr Länder aufgrund der Ausweitung von FTAs bevorzugten Marktzugang erhalten –, verringerter Produktionszeiten und dem Trend zu ‚fast fashion‘, wird die nachhaltige Wettbewerbsfähigkeit der Bekleidungsindustrie in Zukunft nicht mehr allein auf billigen Lohnkosten und DFQF-Marktzugängen beruhen, sondern zunehmend von der Verfügbarkeit eines flexiblen und qualitativ hochwertigen Produktionssystems, das von der Herstellung von Garnen und Stoffen, der Verfügbarkeit von Accessoires und spezifischen Dienstleistungen bei der Endbearbeitung von Textilien, bis zu modernen Logistik und Transportdienstleistungen reicht. Die Bekleidungsindustrie in Vietnam sollte daher ihre Anstrengungen intensivieren, sich als leistungsfähige und qualitativ hochwertige Produzenten international zu positionieren, die sich weg von der Rolle als Lohnfertiger von Bekleidung (CMT – cut, make and trim) hin zu wertschöpfungsintensiveren Produkten unter Ausnutzung lokaler Vorleistungen entwickeln. Dafür erforderlich sind Investitionen für den Auf- und Ausbau einer lokalen Textilproduktion, aber auch das Bereitstellen von anderen Dienstleistungen. So zum Beispiel die Verfügbarkeit von Betriebskapital für die FOB-Produktion, günstige Finanzierungskredite und die Förderung von Ausbildungsmaßnahmen für Arbeitskräfte.

#### **4. Förderung nachhaltiger Entwicklung durch die Handelspolitik braucht kohärente und kontextabhängige Strategien**

Nachhaltige Entwicklung, wie von der UN Agenda 2030 definiert und vom Europäischen Konsens für Entwicklungspolitik bekräftigt, zielt auf die Förderung von wirtschaftlicher Entwicklung ab, die sozial inklusiv ist, die ökologischen Grenzen des Planeten respektiert und Frieden und Demokratie unterstützt. Handelsliberalisierung sollte daher primär als ein Mittel zur Erreichung des Ziels der nachhaltigen Entwicklung begriffen werden. Aufgrund spezifischer geografischer Bedingungen, ökonomischer Strukturen, politischer und institutioneller Systeme, sind die Auswirkungen von Handelsliberalisierung je nach Land unterschiedlich, und es kann nicht generell davon ausgegangen werden, dass die Effekte ausschließlich positiv sind, weder gesamtwirtschaftlich noch auf Ebene einzelner Sektoren. In Übereinstimmung mit dem Prinzip der Politikkohärenz für nachhaltige Entwicklung sollte Handelspolitik daher auf die Spezifika der Partnerländer eingehen und die handelspolitischen Maßnahmen dementsprechend abstimmen. Die Kapitel zu Nachhaltigkeit sind in diesem Zusammenhang ein wichtiger Schritt, allerdings müssten diese durch sämtliche Artikel des Vertragstexts hindurch berücksichtigt werden. Außerdem, sofern diese Kapitel – wie im Falle des EU-Vietnam FTAs – bereits existieren, sind sie in ihrer Ausformulierung verhältnismäßig schwach und der politische Wille, sie zu implementieren und die notwendigen Dialogprozesse zu finanzieren, ist bislang auf beiden Seiten wenig ausgeprägt.

Vietnam befindet sich momentan in einer bedeutenden Übergangsphase, in welcher sich pro-ökonomische Reformer und in Richtung China orientierte Konservative im Kräftering um die wirtschaftliche und politische Zukunft des Landes gegenüberstehen. Handelsabkommen spielen in diesem breiteren Transformationsprozess eine wichtige Rolle, da diese vor allem von den Reform-Befürwortern dazu genutzt werden, die nationalen Libe-

ralisierungsagenden voranzutreiben, sowie von NGOs, um im Kontext des Nachhaltigkeitskapitels Druck hinsichtlich arbeitsrechtlicher Bestimmungen aufzubauen. Ein starkes politisches *Commitment* der EU ist für die effektive Umsetzung des Nachhaltigkeitskapitels daher von besonderer Bedeutung.



# 1. INTRODUCTION

The EU has recently concluded or is currently in the process of negotiating a number of bilateral free trade agreements with both industrialized countries, e.g. Japan, and developing as well as emerging economies. Negotiations with the latter group also include Vietnam, where negotiations were formally concluded in December 2015. After completing the legal review of the text of the agreement, which is underway at the time of finalizing this report (July 2018), the agreement will then be submitted to the Council of Ministers for approval.

Based on the EU trade strategy “Trade for All. Towards a more responsible trade and investment policy”, published in October 2015, these so-called new generation bilateral trade agreements are deliberately designed as ‘deep and comprehensive’ (EC 2015). In other words, while also targeting remaining traditional trade barriers, such as tariffs and quotas, above all they aim at tackling other issues that are deemed relevant for trade. Amongst these figure investment liberalization and protection, intellectual property rights, public procurement, competition law and state aid, as well as non-tariff-measures. The latter include SPS-standards, technical barriers to trade, but also sector regulation and administrative procedures. In addition, it is emphasized by the EU that sustainable development aspects, in particular as they relate to human rights, labor standards as well as environmental aspects also need to be integrated into modern trade policy.

The new EU approach to trade policy has however not remained uncontested. In relation to the now suspended negotiations on a FTA between the EU and the US, the so-called Transatlantic Trade and Investment Partnership (TTIP), as well as to the negotiations between the EU and Canada on the Comprehensive Economic and Trade Agreement (CETA), various stakeholders from EU civil society have both criticized the negotiation process and also voiced concerns with respect to the substantive provisions of the new generation agreements.

As is also stressed by the EC, trade liberalization in the extended definition of the new EU trade agenda must promote sustainable development both in the EU and the partner countries, i.e. economic growth that is socially inclusive and respects ecological boundaries. Furthermore, in the case of trade negotiations with developing countries, the agreements should also take into account the specific situation and needs of these latter countries, so as to be complementary and supportive of their development priorities. In other words, adherence to the principle of policy coherence for sustainable development (PCSD), as recently defined by the UN Agenda 2030 for Sustainable Development and subsequently adopted by the new European Consensus on Development, is required.<sup>1</sup> New generation FTAs are therefore primarily to be assessed against this yardstick, which is the approach adopted in this study with respect to the EU FTAs with Vietnam (EVFTA).

The methodological approach of this report combines both quantitative and qualitative methods. While the economic assessment is based on simulations with the ÖFSE Global Trade Model, a structuralist Computable General Equilibrium model, the qualitative analysis on the agreement and its implementation challenges as well as the case studies draw on text and data analysis, a literature review and interviews in Vietnam. The interviews were conducted with diverse stakeholders from the government, the private sector and

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<sup>1</sup> For the UN 2030 Agenda for Sustainable Development see: [http://www.un.org/ga/search/view\\_doc.asp?symbol=A/RES/70/1&Lang=E](http://www.un.org/ga/search/view_doc.asp?symbol=A/RES/70/1&Lang=E); for the new European Consensus on Development see: [http://www.consilium.europa.eu/en/press/press-releases/2017/06/pdf/European-Consensus-on-Development-2-June-2017-Clean\\_final\\_pdf/](http://www.consilium.europa.eu/en/press/press-releases/2017/06/pdf/European-Consensus-on-Development-2-June-2017-Clean_final_pdf/) (12.07.2017).

civil society, and complement other data sources used throughout the report (see a list of interviewees in Appendix).

The report assesses the EVFTA between the EU and Vietnam. The report starts with an economic overview and an analysis of the trade patterns between the EU and Vietnam (Section 2). In section 3, the key contents of the EVFTA are assessed. This includes a detailed analysis of the market access offer and other key issues, as well as a discussion of the trade and sustainable development aspects of the respective agreement, and finally of EU development cooperation in the partner country. Section 4 analyzes the economic implications of the EVFTA on Vietnam. The section starts with an assessment of the economic impacts of the agreement, based on simulations with the ÖFSE Global Trade Model. Based on interviews with stakeholders and field research in the partner country, negotiating concerns and implementation challenges associated with the agreement are detailed in the subsequent section. Further, sectoral case studies are analyzed in order to investigate the potential of the EVFTA on the export side, highlighting the opportunities and challenges for export promotion policies in the context of global value chains and related lead firm strategies as well as local competitiveness conditions. The sectoral case studies focus on the textile and apparel sector and the aquaculture sector.

Section 5 provides a summary of the main findings with respect to economic impacts, the sectoral case studies and the sustainability concerns. Upon that basis, key policy recommendations are proposed in the areas of adjustment assistance and productive development promotion.

## 2. VIETNAM: ECONOMIC OVERVIEW AND TRADE RELATIONS

Against the background of internal weaknesses of the Vietnamese economy in the late 1970s and 1980s, a series of reforms was adopted starting in 1986, which gained momentum after the collapse of the Soviet bloc in 1989. The 'doi-moi' (renovation) reforms were intended to transform Vietnam into a 'socialist market economy under state guidance' and included the gradual liberalization of the domestic economy and the development of a private sector as well as the shift towards a more market-based system of foreign trade. A new era of export-led growth began alongside the attraction of foreign investment. State-owned enterprises (SOEs) played however still a crucial role in the economy and the industrial development strategy. This reform process continued throughout the 1990s as Vietnam increasingly integrated into the global economy. Overall, Vietnam has gone through a structural transformation with an increase in industrial production as reflected by changes in the composition of the export basket (see Table 1).

*Table 1: Structural transformation Vietnam*

| Share of GDP (in %) | 1990 | 2000 | 2015 |
|---------------------|------|------|------|
| Agriculture         | 39   | 25   | 19   |
| Industry            | 23   | 37   | 37   |
| Services            | 39   | 39   | 44   |

| Major Export Goods | Crude Oil   | Crude Oil    | Electronics          |
|--------------------|-------------|--------------|----------------------|
|                    | Seafood     | Footwear     | Textiles and Apparel |
|                    | Milled Rice | Seafood/Fish | Footwear             |

Source: GSO, WDI, OEC

Vietnam was able to continue its dynamic growth in recent years with an average growth in GDP of 6.0% between 2010 and 2015 (Table 2). In particular, the continuous inflow of foreign direct investment and the switch to a current account surplus enabled the positive economic development.

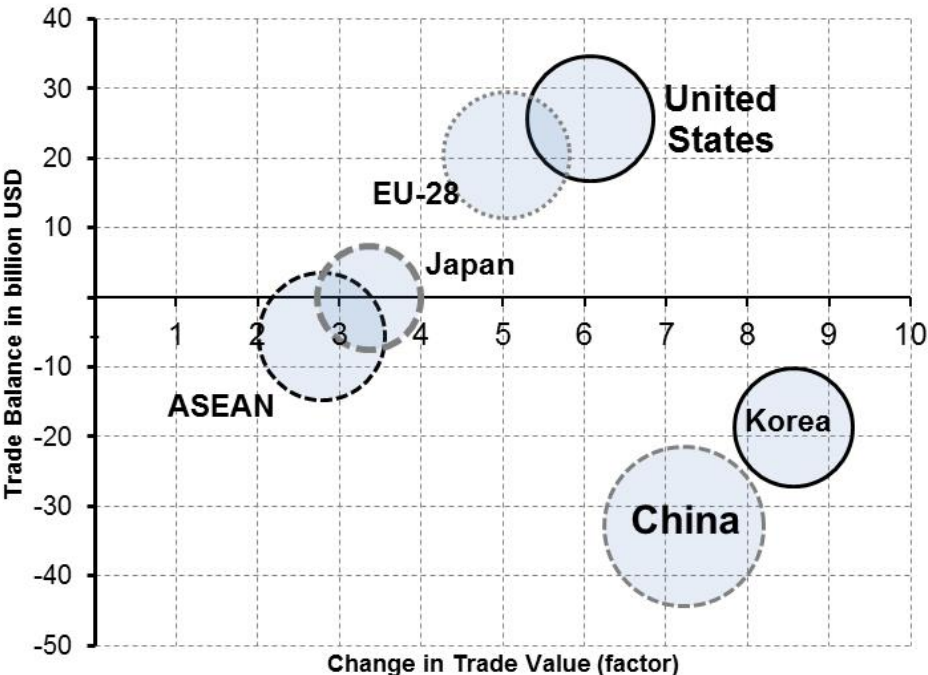
*Table 2: Key economic indicators of Vietnam*

|   | 2010   | 2011   | 2012   | 2013   | 2014   | 2015   |
|---|--------|--------|--------|--------|--------|--------|
| Nominal GDP (current VND, trillion)               | 2,158  | 2,780  | 3,245  | 3,584  | 3,938  | 4,193  |
| Nominal GDP (current USD, billion)                | 115.9  | 135.5  | 155.8  | 171.2  | 186.2  | 193.6  |
| GDP per capita (current USD)                      | 1,334  | 1,543  | 1,755  | 1,908  | 2,052  | 2,111  |
| Real GDP growth (annual %)                        | 6.4    | 6.2    | 5.2    | 5.4    | 6.0    | 6.7    |
| Inflation, consumer prices (annual %)             | 8.9    | 18.7   | 9.1    | 6.6    | 4.1    | 0.9    |
| Current account (net, % of GDP)                   | -3.7   | 0.2    | 6.1    | 4.5    | 5.0    | 0.5    |
| Foreign direct investment, net inflows (% of GDP) | 6.9    | 5.5    | 5.4    | 5.2    | 4.9    | 6.1    |
| Exchange rate (VND per USD, period average)       | 18,613 | 20,510 | 20,828 | 20,933 | 21,148 | 21,698 |

Source: WB-WDI 2017

Changes in the trade relations of Vietnam are an indicator for the dynamic development experienced by Vietnam over the last decade. Figure 1 shows the change in trade volume in 2015 compared to 2005 (x-axis), the balance in trade in goods (y-axis) and the trade volume in 2015 (size of the bubble) of Vietnam's top trading partners. The trade value (imports and exports) has increased drastically. For instance, trade with China surged by more than 700%; trade with the EU by a factor of five. A clear pattern is visible with regard to the trade balance in goods as Vietnam has a trade deficit with its major Asian trading partners, in particular with China, and a trade surplus with the EU and the United States. Overall, Vietnam's merchandise exports and imports are currently balanced.

Figure 1: Vietnam Trade Dynamics



Notes: Bubble size indicated Trade value (imports plus exports); in 2015, Vietnam's trade volume with China amounted to USD 66 billion.  
 Source: UN Comtrade 2017

Trade patterns with the EU show that Vietnam has a clear surplus in merchandise trade of almost EUR 24 billion in 2016 (Table 3). The positive balance widened dynamically over the last decade from a trade surplus in goods of EUR 3.7 billion in 2005 (Eurostat 2017). Thus, Vietnam emerged as an important source for imports for the EU, ranked as 10<sup>th</sup> most important source country for merchandise imports in 2016 (EC 2017b). The major import goods from Vietnam are electronic goods, machineries, footwear and apparel. In addition, agricultural goods such as coffee are relevant. On the other side, exports from the EU to Vietnam consist mainly of machineries, chemicals, pharmaceutical products and transport equipment (Table 4). Trade in services between the EU and Vietnam has also increased in recent years and is almost balanced. In 2015, the EU exported services worth EUR 1.8 billion to Vietnam and imported services of EUR 1.7 billion (EC 2017a).

Table 3: EU-Vietnam trade patterns (2016)

|                                 | EU-Imports | EU-Exports | Total  | Balance (VIE) |
|---------------------------------|------------|------------|--------|---------------|
| EU-VIE trade (million EUR)      | 33,064     | 9,332      | 42,396 | 23,732        |
| % share of EU trade             | 1.9        | 0.5        |        |               |
| % growth rate 2015-2016         | 10.3       | 10.7       |        |               |
| % average growth rate 2012-2016 | 15.4       | 14.8       |        |               |

Source: EC 2017b

Table 4: EU-Vietnam trade by products (million EUR, HS 2 level)

|                                      |   | 2000         | 2005         | 2010         | 2015          |
|--------------------------------------|---|--------------|--------------|--------------|---------------|
| <b>Total EU-Imports from Vietnam</b> |   | <b>4,294</b> | <b>5,585</b> | <b>9,623</b> | <b>29,971</b> |
| <b>HS Code</b>                       | <b>Product</b>                          |              |              |              |               |
| 85                                   | Electrical Machinery and Equipment      | 92           | 88           | 736          | 10,737        |
| 84                                   | Machinery                               | 10           | 83           | 495          | 4,295         |
| 64                                   | Footwear                                | 1,734        | 2,115        | 2,103        | 3,583         |
| 62                                   | Apparel, not knitted                    | 648          | 521          | 986          | 2,013         |
| 9                                    | Coffee                                  | 395          | 392          | 798          | 1,463         |
| <b>Total EU-Exports to Vietnam</b>   |   | <b>5,723</b> | <b>6,115</b> | <b>8,356</b> | <b>9,332</b>  |
| <b>HS Code</b>                       | <b>Product</b>                          |              |              |              |               |
| 84                                   | Machinery                               | 324          | 382          | 987          | 1,817         |
| 88                                   | Aircraft                                | 22           | 57           | 522          | 1,149         |
| 30                                   | Pharmaceutical Products                 | 135          | 159          | 314          | 702           |
| 85                                   | Electrical Machinery                    | 177          | 266          | 392          | 497           |
| 90                                   | Optical, Measuring, Medical Instruments | 49           | 68           | 191          | 354           |

Source: Eurostat 2017

### 3. ASSESSMENT OF KEY CONTENTS OF THE EVFTA

The EVFTA is a comprehensive trade agreement that contains 18 chapters, including a trade in goods chapter and topics directly affecting trade flows (e.g. TBT, SPS, RoO, etc.) as well as chapters on services, investment, government procurement, state owned enterprises, competition, intellectual property rights and sustainability.<sup>2</sup> The EVFTA has an important role in the region as it is the first FTA the EU has signed with an ASEAN member state and is therefore seen as a first step into the ASEAN region with potentially important economic benefits for Vietnam in the context of regional investment and trade strategies. The focus of this chapter is to analyze the key contents of the EVFTA with a focus on provisions that directly affect trade in goods.

#### 3.1. Market access offer

The EVFTA includes an almost full and reciprocal liberalization of merchandise trade with regard to tariffs. Only a limited number of goods face tariff rate quotas (TRQ) with duty free access only within specified quantities. In the EU market, these TRQs concern agricultural and food products, for instance rice, mushrooms, high-sugar-containing products and canned tuna. Certain vegetables and fruits are still part of an EU entry price system, which should prevent low price competition from third countries. Taking into account these exemptions, the EU offers Vietnam DFQF-access to its market for 98.9% of all tariff lines (CN8) listed in the agreement, which is equivalent to 99.8% of EU's import value from Vietnam.

On the other side, Vietnam grants DFQF access for 99.7% of all tariff lines listed in the agreement, which is also equivalent to 99.8% of Vietnam's import value from the EU. The major exemptions in form of TRQs include eggs, raw tobacco, salt and sugar of Vietnam's import value from the EU.<sup>3</sup> In addition, the tariff liberalization in the automobile sector excludes 'completely knocked down' vehicles.

The economic effects of trade liberalization on trade in goods also depend on the extent of currently granted DFQF access, the level of tariff protection, the sectoral trade patterns and the implementation schedule. Vietnam had already GSP status with regard to market access into the EU. Hence, the EU already grants DFQF access for 24.5% of all tariff lines or almost 59% of the import value from Vietnam. When the agreement enters into force, an additional 60% of all tariff lines, equivalent to 23% of trade value will be liberalized. The remaining tariffs will be reduced in 4, 6 and 8 equal annual steps, including in the first year of the agreement (see Table 5).

For Vietnam the liberalization schedule is extended up to 15 years for selected products. However, almost 80% of tariff lines – equivalent to 90% of import value from the EU – are to be liberalized 6 years after the agreement enters into force. In an initial step, 15.7% of tariffs lines in addition to the already 33% of tariff lines (or 61.6% of trade value) that grant

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<sup>2</sup> Chapter 1: Objectives and Definitions; Chapter 2: National Treatment and Market Access for Goods; Chapter 3: Trade remedies; Chapter 4: Rules of Origin; Chapter 5: Custom and Trade facilitation; Chapter 6: Technical Barriers to Trade; Chapter 7: Sanitary and Phytosanitary Measures; Chapter 8: Trade in Services, Investment and E-Commerce; Chapter 9: Government procurement; Chapter 10: State Owned Enterprises; Chapter 11: Competition policy; Chapter 12: Intellectual property; Chapter 13: Dispute settlement; Chapter 14: NTBs and investment in renewable energy generation; Chapter 15: Trade and sustainable development; Chapter 16: Cooperation and capacity building; Chapter 17: Institutional, general and final provisions; Chapter 18: Transparency

<sup>3</sup> In 2016, the value of EU exports to Vietnam of these products amounted to less than EUR 8 million.

DFQF access to Vietnam, are set to zero. Thus, almost 70% of trade value can be exported DFQF to Vietnam with the start of the agreement (see Table 6).

Table 5: Tariff liberalization schedule – EU offer to Vietnam

|  | Tariff lines<br>(share in %) | Trade volume<br>(share in %) |
|--|------------------------------|------------------------------|
| <b>With the start of the agreement (t)</b> | 83.7                         | 81.9                         |
| <i>Of which already DFQF</i>               | 24.5                         | 58.7                         |
| <b>Year t + 3 (4 annual steps)</b>         | 6.7                          | 7.4                          |
| <b>Year t + 5 (6 annual steps)</b>         | 4.2                          | 7.6                          |
| <b>Year t + 7 (8 annual steps)</b>         | 4.3                          | 2.8                          |
| <i>No DFQF access</i>                      | 1.1                          | 0.25                         |

Notes: Trade volume refers to annual average of trade between 2013 and 2015.

Source: UN Comtrade 2017

Table 6: Tariff liberalization schedule – Vietnam offer to EU (%)

|  | Tariff lines | Trade value |
|--|--------------|-------------|
| <b>With the start of the agreement (t)</b> | <b>48.5</b>  | <b>69.5</b> |
| <i>Of which already DFQF</i>               | 32.8         | 61.6        |
| <b>Year t + 3 (4 annual steps)</b>         | 10.3         | 4.7         |
| <b>Year t + 5 (6 annual steps)</b>         | 20.9         | 15.0        |
| <b>Year t + 7 (8 annual steps)</b>         | 12.1         | 7.6         |
| <b>Year t + 9 (10 annual steps)</b>        | 0.4          | 0.6         |
| <b>Year t + 10 (11 annual steps)</b>       | 6.4          | 2.4         |
| <b>Year t + 14 (15 annual steps)</b>       | 0.2          | 0.1         |
| <i>No DFQF access</i>                      | 1.1          | 0.2         |

Notes: Trade volume refers to annual average of trade between 2013 and 2015

Source: UN Comtrade 2017

### 3.2. Key issues

Like all FTAs, the EVFTA also reduces the **policy space** for economic policies in signatory countries. The EVFTA, for example, includes a non-revisable standstill-clause (Chapter 2: Article 7), a national treatment provision in accordance with Article III of the GATT 1994 (Article 12) and a limitation on the application of export taxes (Article 9). Article 9 states that no new export taxes shall be introduced and existing export taxes shall be reduced within 16 years at the latest, however, export taxes on specific goods are excluded or are only partially affected (esp. various resources such as ore, gold and oil).

The options for **trade remedies** in the EVFTA are relatively limited. The EVFTA includes options for anti-dumping and countervailing duties as well as multilateral safeguards according to GATT and WTO agreements. Bilateral safeguards, which allow for an increase of tariffs up to MFN level or the base rate of the EVFTA tariff schedule, might be adopted if domestic industries are threatened by EU imports due to the reduction or elimination of tariffs for up to four years. The parties would thus need to prove a relationship between



tariff reduction and negative economic impact, requiring strong institutional capacities and capabilities. After the transition period of ten years, the bilateral safeguard can only be implemented with the consent of the other party. The EVFTA does not include an infant industry safeguard, even though the EVFTA is a FTA between unequal partners, the relative complementarity of production systems and the export surplus of Vietnam vis-à-vis the EU notwithstanding. The little room of the EVFTA to adopt safeguard measures, e.g. compared to Economic Partnership Agreements of the EU with ACP countries, might hamper policy space to implement industrial policies or measures to mitigate negative effects in certain sectors due to tariff liberalization, even though the EU's share of total imports of Vietnam amounts only to 6.2% (UN Comtrade 2017).

Changes in the **rules of origin (RoO)** may also have important impacts on trade relationships. The EVFTA-RoO have many similarities with GSP-RoO so major impacts are not to be expected (see Chapter 4). In the T&A sector, the double transformation rule ('fabric forward') will continue to apply, meaning that fabrics need to be produced in Vietnam in order for apparel products to qualify for DFQF access to the EU. The EU did not want to grant 'single transformation' since it would allow cheap Chinese fabrics to enter the EU via apparel manufacturing in Vietnam. The cumulation rules are also relatively strict and only allow for bilateral and extended cumulation with selected countries and sectors. The EVFTA, for example, allows for cumulation with South Korea for textiles, since South Korea also has an FTA with the EU. The cumulation rules are also more relaxed for cuttlefish and squid with ASEAN countries that have or will have a FTA with the EU. Article 37 of Chapter 4 also takes into consideration that the EVFTA-RoO might need to be adopted "[...] to ensure coherence between the Rules of Origin applicable within the context of the preferential exchanges between ASEAN countries and the EU."

In general, strict RoO limit the flexibility of companies to source their inputs in order to qualify for DFQF exports to the EU. In the fisheries sector, for example, the 'wholly obtained' principle without cumulation possibilities limits the industry's flexibility to react to the seasonality of supply of various fish. In certain industries, however, more strict RoO might operate as an opportunity for functional upgrading, such as in the T&A sector, since local and foreign companies might be incentivized to invest into the Vietnamese textile industry in order to obtain DFQF to the EU (and other countries) (see Section 7.3).

The general impact of the trade liberalization will heavily depend on the private sector capacities and capabilities to utilize the EVFTA-RoO. In case of the GSP-RoO, the gains of utilizing existing trade preferences were limited due to the relative small tariff reduction in case of GSP (generally 3.5 percentage points). The potential gains of utilizing trade preferences in case of the EVFTA would be considerably larger, increasing the importance of supporting measures (see Section 3.4).

The EVFTA also includes chapters on **NTBs, TBT, SPS and customs and trade facilitation** issues with the goal to enhance market access and trade between the parties. The chapters related to these issues put the burden of adjustments on Vietnam, since the EU trade regime is already relatively liberalized and relevant international standards are applied.

Provisions on NTBs reduction (Chapter 14) hold that the parties shall implement international standards (such as ISO and IEC) in the machinery and electrical machinery sector. The EVFTA also aims to reduce NTBs on pharmaceutical products and medical devices as well as motor vehicles and motor vehicle parts (see esp. Annexes of Chapter 2). The recognition of standards in the automotive sector (UNECE regulations) might in combination with tariff liberalization increase EU exports to Vietnam. The Vietnamese automotive sector, however, is expected to be more affected by ASEAN tariff liberalization scheduled



for 2018. Vietnam will furthermore strengthen intellectual property rights (such as patent protection and data protection), recognize international standards of and ease market access for pharmaceutical products, which represent 9.7% of total imports from the EU in 2016 (Eurostat 2017). The Delegation of the EU to Vietnam argues that the EVFTA will enable the Vietnamese population to better access high quality and innovative drugs from the EU (DEUV 2016: 30).

Vietnam also agrees to adopt international standards (e.g. ISO, IEC, ITU and the Codex Alimentarius) as basis for their technical regulations (Chapter 6: Article 4). The adoption of international standards will likely ease the market access for both parties. Vietnam's exports might also benefit due to enhanced market access to other major markets. However, Vietnam will have to bear adjustment costs in the short run.

Various provisions in the SPS chapter (Chapter 7) aim at improving market access for both parties and in particular for EU products to Vietnam, including a harmonization of requirements for different EU states and the adoption of the equivalence principle. The equivalence principle holds that both parties shall accept SPS measures of the exporting party as equivalent if the level is demonstrated to be at the importing party's appropriate level of SPS protection. In general, Vietnam would have to raise SPS standards and controlling mechanisms since the EU's standards can generally be considered to be at a higher level. The EVFTA does not allow for mutual recognition, which would have likely benefitted Vietnam's market access to the EU.

The chapter on customs and trade facilitation (Chapter 5) aims to decrease bureaucratic barriers to trade and include provisions on the cooperation and exchange of information between custom authorities as well as transparency and commitments for simplification and standardization of rules, data and documentation.

The parties furthermore agree to partially liberalize **cross-border supply of services** (Chapter 8 and Annex 8d). The cross-border supply of services is subject to a national treatment and most favored nation provision. Various service (sub-)sectors have certain limitations on market access and national treatment (Annex 8d). The chapter furthermore does not apply to the audio-visual services, national maritime cabotage and various air transport services.

The EVFTA includes an **investment chapter** (Chapter 8 and Annexes) that goes beyond and will replace the 21 existing bilateral investment treaties (BITs) between Vietnam and the EU (DEUV 2016: 52). Like BITs, the EVFTA includes clauses<sup>4</sup> to protect the interest of investors (Chapter 2: ch. II). The EU is currently the 5<sup>th</sup> largest FDI partner of Vietnam with investments of USD 23.2 billion and 1,730 projects (DEUV 2016: 16f.). Alone in 2015, EU companies invested USD 1.5 billion in Vietnam. Most of the investment conducted by EU companies has been channeled to the manufacturing sector (USD 6.6 billion), real estate (4.6) as well as electricity production and transmission (3.5). The EVFTA extends liberalization compared to the BITs in food products and beverages (including fish and aquaculture) products, fertilizers and nitrogen composites, tires, tubes and other plastic products, ceramics and cane sugar (DEUV 2016: 52f.). In general, the impact can be expected to be relatively small due to existing BITs, however, some sectors (e.g. food production) might experience a meaningful increase in FDI according to interviews with stakeholders in Vietnam.

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<sup>4</sup> National treatment, most favored nation, fair and equitable treatment, full protection and security, protection from expropriation, permission for transfers, compensation for losses due to war as well as conflict and so on (Chapter 2, ch. II, Section 2).

Under the framework of the WTO, Vietnam has made market access commitments for foreign investors in 11 service sectors as well as hundreds of service sub-sectors to a different extent. The EVFTA will extend market access to various service sectors (e.g. communication, distribution, transport and other services) compared to WTO commitments vis-à-vis the EU, however, various service (sub-)sectors will retain restrictive market access (see Chapter 8 and Annexes as well as Trang 2017 and DEUV 2016: 4ff. for more details).

The EVFTA will establish an investor-state dispute settlement (ISDS), including a permanent tribunal to judge claims related to the protection of investments (Chapter 8: annexes). The new ISDS mechanism of the EVFTA, termed “Investment Court System (ICS)” by the EC, will be similar to the Comprehensive Economic Trade Agreement (CETA) between the EU and Canada incorporate various new features compared to the ‘standard ISDS’, including a roster of appointed members, an appeal mechanism and improved ethical standards for members of the court (see Lenk 2016).

The EU and Vietnam furthermore committed to reduce barriers to access **public procurement** (see Chapter 9 and associated Annexes). The EVFTA defines thresholds for Vietnamese public procurement, which differ between public entities (ministries, cities, public companies, universities, etc.) as well as construction services and other goods and services. The thresholds for public procurement will be reduced within 15 years after the entry into force of the agreement. EU companies are likely to benefit more from the partial liberalization of public procurement due to higher availability of capacities and capabilities to access foreign markets. Market access to the EU public procurement for Vietnamese companies will be hampered by high competition as well as costs of market entrance.

The **competition policy chapter** (Chapter 11) aims to promote comprehensive competition legislation that proscribes anticompetitive conduct (section I). The parties will maintain their autonomy in developing as well as enforcing competition law. The EVFTA furthermore demands that all enterprises, private or public, shall be subject to the competition law (Chapter 11, Section 1, Article 3:3), however, the application of the competition law should not obstruct the performance of particular tasks of public interest assigned to respective enterprises. The competition policy chapter furthermore limits the application of subsidies (section II), as they will only be permissible in cases where they are necessary for achieving a public policy objective<sup>5</sup> and in principle should not be granted when they negatively affect competition and trade (Article x.1). Subsidies to promote agricultural exports will be completely forbidden and some subsidies, e.g. loans to support insolvent or ailing enterprises, are subject to conditions (see Section II, Article x.6).

The relationship between **state-owned** (SOE) and private **enterprises** is the subject of chapter 10. The chapter aims at increasing transparency of SOEs commercial activities and ensuring that laws and regulations are enforced in a consistent and non-discriminatory manner. Given the high level of corruption and inefficiency related to SOE on the one side, and the importance of SOE for industrial development on the other side, there is potential that the chapter on SOEs can contribute to a more productive role of SOEs for future economic development (see Herr/Schweissheim/Vu 2016).

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<sup>5</sup> Article x.1 of Section II in Chapter 11 offers an ‘illustrative list’ of objectives for which subsidies could be granted, such as making good the damage of natural disasters, promoting the economic development of areas with low standard of living, promoting certain economic activities (in particular research and development) and others.

### 3.3. Sustainability chapter

In 2015, the European Commission (EC) proposed a new trade and investment strategy for the European Union. The strategy, named “Trade for All. Towards a more responsible trade and investment policy”, should not only benefit consumers, workers, citizens and SMEs in the EU but also in developing countries. The latter should be realized by drawing a link between trade and sustainable development. That means, that trade liberalization, which is the unchanged goal of EU’s international trade relations, has to go “hand in hand with social justice, respect for human rights, high labor and environmental standards, and health and safety protection” (EC 2015: 22).

In this context, provisions relating to sustainable development have become the norm in recent EU FTAs. In so-called ‘new generation’ FTAs Trade and Sustainable Development (TSD) chapters explicitly address labor and environmental issues (Harrison et al. 2016). Typically, the EU approach to trade and sustainability includes the following key elements: (i) human rights, (ii) social issues and labor rights, (iii) and environmental sustainability. Firstly, we will provide an overview of the general EU approach with respect to these issues (drawing on Bilal/Ramdoon 2016) and then, secondly, discuss in detail the provisions under the EVFTA. Finally, we will discuss the EU approach the light of its enforceability and in comparison to other FTAs.

#### 3.3.1. The General EU Approach to Trade and Sustainable Development

##### *(i) Human rights:*

Though human rights clauses have become a part of EU trade agreements already since 1995, the Lisbon Treaty of 2009 declared them an *essential element* and thus mandatory for EU Trade Policy. Interestingly, the human rights dimension in trade agreements is not only about the prevention of violations of human rights. It is also about promotion of human rights, as well as ensuring that FTAs do not unduly restrict the policy space of its partners, which could have negative human rights effects.

Similarly to other recently concluded FTAs (i.e. the Economic Partnership Agreements) the EVFTA contains a non-execution clause, which allows any party to take ‘appropriate measures’ in case of a breach of the ‘essential elements’ and therefore in case of human rights violations.

##### *(ii) Labor rights and social standards:*

The EU approach contains two elements, which are distinct but inter-related, i.e. social policy and labor rights.

Firstly, a set of provisions argues for ‘social policy’. These are generally ‘soft’ policies that endorse for instance, the recognition that social policies such as decent work that take into account gender and youth dimensions are conducive to development. Other provisions also engage countries in agreeing not to use social policies as protectionist trade measures. There are generally no sanctions-based enforcement mechanisms. However, there are consultative mechanisms – Consultative Committees in case of EPAs and Domestic Advisory Groups (DAGs) in case of EVFTA – that allow for monitoring by stakeholders and civil society. Most clauses are of a best endeavor nature, but nevertheless provide for an implementation mechanism that rests upon cooperation between partner countries.

Secondly, labor 'rights' are covered, which essentially endorses legal commitments to respect core labor standards as 'rights'. These relate both to national labor law and international labor standards. The latter include in particular the 1998 Declaration of the International Labor Organization (ILO) on the Four Core Labor Standards. In contrast to other recent EU FTAs (i.e. EPAs), EVFTA requires the partner countries to "make continued and sustained efforts of ratifying" (TSD chapter, Article 3) the fundamental ILO conventions. Besides an obligation to enforce labor laws, labor 'rights' provisions also require countries not to reduce their levels of protection, and to encourage countries to even raise their levels of protection, subject to a proviso that this must not be done for protectionist purposes.

Importantly, and contrary to established US practices which foresee the possibility of sanctions and submit the labor rights chapter to standard dispute settlement procedures as well as demands that certain standards are met prior to the FTA coming into force (De Ville et al. 2016), the EU has so far adopted an approach that is confined to dialogue and capacity building (see also below).

### *(iii) Environmental sustainability*

Substantive environmental provisions have been introduced in most EU agreements at the same time as social standards and labor rights under sustainable development clauses in 2006. Environmental provisions fall into two broad categories:

- (a) Provisions that seek to protect or enhance the environment. Parties are required to enforce existing domestic environmental laws and regulations and are required not to weaken their environmental regimes in order to attract investment. Countries' 'right to regulate' is affirmed, which means that the agreement does not 'impose' standards. Countries also recognize and agree to support and comply with Multilateral Environmental Agreements (MEA) to which the parties are members.
- (b) Environmental cooperation, where parties agree to cooperate on a list of agreed areas but without taking binding commitments to regulate trade through environmental standards.

The provisions are framed in best-endeavor terms, meant to enhance cooperation. So far there are no particular mechanisms to trigger sanctions in case parties do not respect their commitments. The EU approach to environmental sustainability is therefore similar to that used to foster social standards and labor conditions. It is based on 'persuasion' rather than 'coercion', therefore relying on soft mechanisms of enforcement. However, environmental provisions may be possibly subsumed under the non-execution clause (see PCA-EVFTA).

### **3.3.2. Provisions on Trade and Sustainable Development within the EVFTA**

The agreement with Vietnam is considered as the most ambitious and comprehensive that the EU has concluded so far with a developing country. This is even more emphasized with regard to the sustainable development provisions of the agreement (EC 2016: 7). Whereas human rights issues are discussed at several points throughout the EVFTA, the agreement contains a comprehensive chapter on trade and sustainable development (TSD) which includes besides human rights also labor and environmental standards (Chapter 15).

In 2016, the EC published a working document regarding human rights and sustainable development in EU-Vietnam relations with specific reference to the EVFTA. It argued that "when considering the impact of trade policies on human rights issues and ways to address them, the EU's overall relations with the country concerned should be taken into account"

(ibid: 3). Therefore, the EC points to the Partnership and Co-Operation agreement (PCA) signed in June 2012. The following discussion will hence take into account the PCA as a framework of reference for the provisions provided under the EVFTA, followed by a discussion of the main contents of the Chapter on Trade and Sustainable Development.

### **Partnership and Co-Operation agreement (PCA)**

In 2007, negotiations for a PCA with Vietnam were launched and finally concluded in 2012. According to the EC, the PCA demonstrates the commitment of the EU to forge a modern, broad-based and mutually beneficial partnership with Vietnam. It is based on shared interests and principles such as equality, mutual respect, the rule of law, and respect for human rights as laid down in the Charter of the United Nations, in the UN General Assembly Universal Declaration of Human Rights, and in other relevant international human rights instruments to which both parties have committed themselves.

Article 1 of the PCA already contains EVFTA-relevant provisions. Firstly, it underlines the respect for human rights, democratic principles and the rule of law. This so-called “human rights clause” – as an essential element of the agreement – assures that human rights are a subject of common interest. Moreover, the clause depicts a legally binding expression of the parties’ shared commitment to the promotion and protection of human rights. Secondly, the parties express their commitment to support sustainable development in all its dimensions. Article 2 concerning the aims of cooperation specifies this commitment in the areas of trade and investment (“in order to facilitate sustainable trade and investment flows”) and development cooperation (“working towards promoting sustainable development”) (PCA 2012: 99). The commitment to human rights and sustainable development is repeated in several articles throughout the agreement.

The main tool for the implementation of the human rights dimension of the PCA is the annual human rights dialogue. Involving human rights experts from both parties and partly based on consultations with civil society the dialogue takes place at senior representatives’ level and is held yearly on an alternating basis in Brussels and Hanoi. It is seen as a “valuable instrument for raising and addressing human rights issues, including concerns, in a direct and frank manner between the representatives of both sides” (EC 2016: 5) Next to human rights, social, economic and cultural rights have been raised. If a party fails to fulfil its obligations under the PCA the other party is empowered to take “appropriate measures”, including as a last resort the suspension of the agreement.

### **PCA and EVFTA**

In the Preamble of the EVFTA, both the EU and Vietnam affirm their longstanding and strong partnership based on the common principles and values reflected in the PCA. In a working document, the EC states that the EVFTA “does not stand in isolation, but is integrated with the PCA. This ensures a continuous link between political and economic aspects in the relationship between the EU and Vietnam” (EC 2016: 7).

In addition to the link between the PCA and the EVFTA, the Preamble of the EVFTA reaffirms the commitment of the partners to the UN Charter and the principles contained in the UN Universal Declaration of Human Rights of 1948. Article X.17 of the Chapter on Institutional, General and Final Provisions strengthens the link between human rights and free trade once again and points to possible sanctions. Analogically to the non-execution clause in the PCA, it allows any party to take “appropriate measures” with respect to the EVFTA in case of a material breach of the PCA.

With regard to the implementation of the EVFTA’s human rights dimension, the EC refers to the PCA: “Since the basic human rights commitments are established under the PCA,



this agreement also sets up the institutions and structures, including the human rights dialogue, which are the primary platform for discussions on human rights issues between the EU and Vietnam, also with regard to relevant human rights developments in Vietnam” (EC 2016: 10).

### **EVFTA Chapter on Trade and Sustainable Development**

While the human rights dimension within the EVFTA therefore can be seen as reaffirming the provisions already laid down in the PCA and underlining their importance in the area of trade and investment, the chapter on TSD in the EVFTA extends and specifies the issues raised under the PCA.

The EC describes the aims of the chapter on TSD as two-fold. On the one hand, it aims to “promot[e] mutual supportiveness between trade and investment, labour, and environmental policies” and on the other hand it wants to “ensur[e] that increased trade and investment do not come at the expenses of workers’ and environmental protection – but rather support it” (EC 2016: 8).

Whereas Article 1 and 2 of the chapter set out the “context, objectives and scope” and the “right to regulate and levels of protection”, Article 3 contains a declaration of the commitment to international, multilateral labor standards. Both parties are obliged to “make continued and sustained efforts towards ratifying [...] the fundamental ILO conventions” and therefore, to respect, promote and effectively implement the principles concerning the fundamental rights at work.

Article 4-8 are devoted to environmental aspects. Reflecting the “need to enhance the mutual supportiveness between trade and environment” the parties commit to consult and cooperate “as appropriate” with respect to trade-related environmental issues of mutual interest and to implement effectively the multilateral environmental agreements to which they are parties (Article 4). Article 5-8 stress certain areas where action considered relevant: climate change, biological diversity, sustainable forest management and trade in forest products, and trade and sustainable management of living marine resources and aquaculture products. The parties agree to engage in dialogue, share information and experiences and cooperate in certain aspects.

To fulfill the comprehensive aim of the chapter, namely to “enhance the contribution of trade and investment to the goal of sustainable development in its economic, social and environmental dimensions” (Article 9) the agreement identifies five essential tasks:

- a) Recognize the beneficial role that decent work has for efficiency, innovation and productivity and enhance greater policy coherence between trade policies and labor policies
- b) Facilitate and promote trade and investment in environmental goods and services
- c) Facilitate trade and investment in goods and services of particular relevance for climate change including the deployment of best available technologies
- d) Encourage the development of and participation in voluntary initiatives that contribute to the achievement and maintenance of high levels of environmental and labor protection and complement domestic regulatory measures
- e) Promote corporate social responsibility

The ensuing articles 10 to 13 contain further stipulations regarding measures and their implementation. Article 10 obliges the parties to uphold their recent levels of protection and not to encourage trade or investment by weakening the levels of protection afforded

in domestic environmental or labor laws. Article 11 and 12 ensure the provision of scientific and transparent information when preparing and implementing measures aimed at protecting the environment or labor conditions that may affect trade or investment. Article 13 calls for a joint or independent review, monitoring and assessment of the impact of the EVFTA on sustainable development.

Finally, articles 14 to 17 lay out the details with respect to the implementation. Whereas Article 14 lists several areas in which the parties may cooperate, the articles 15 to 17 specify the institutional set-up and responsibilities. Aside from the designation of a contact point within the administration of each party for the purposes of implementing the chapter, the chapter calls for the following institutions to be established:

- Specialized Committee on Trade and Sustainable Development
- Domestic Advisory Groups (DAGs) and Joint Forum
- Panel of Experts

The Specialized Committee on Trade and Sustainable Development comprises senior officials from the relevant administrations of each party or officials the parties designate. It shall meet within the first year after the date the EVFTA enters into force. Its purpose is to review the implementation of the chapter including the co-operation activities undertaken under Article 14.

The DAGs, on the other hand, should comprise “independent representative organizations, ensuring a balanced representation of economic, social and environmental stakeholders, including among others employers’ and workers’ organizations, business groups, and environmental organizations.” (Article 15) The parties convene and appoint the DAGs and their members basing on domestic procedures. DAGs pursue the task to submit views and recommendations of their own initiative and to advice on the implementation of the chapter.

In the Joint Forum, members of the DAGs of both parties should meet once a year to conduct a dialogue. By joint agreement, the DAGs are allowed to involve other stakeholders in forum meetings. The forum is based on a balanced representation of economic, social and environmental stakeholders. The reports of meetings of the Joint Forum are submitted to the Specialized Committee and thereafter made publicly available. The Joint Forum should meet no later than one year after the entry into force of the EVFTA.

Article 16 and 17 provide specific mechanisms for the settlement of disputes arising under the chapter. This implies that the chapter is not subject to the dispute settlement provisions of the EVFTA as agreed on under Chapter 13. To resolve disputes the Contact Point and the Specialized Committee in consultation with the DAGs are the first authorities to become involved. If they cannot contribute to the solution of the issue a party may request that a Panel of Experts (Article 17) be convened in order to examine the matter. As soon as a matter is transferred to the Panel of Experts, it examines it “in the light of the relevant provisions of the Trade and Sustainable Development Chapter” and issues “reports [...] making recommendations for the solution of the matter”. After the submission of the final report of the Panel of Experts the parties have to discuss appropriate actions or measures for implementation.

### **3.3.3. Discussion of EU approach**

In the EVFTA, the EU continues its ‘promotional’ strategy with respect to sustainable development by strengthening frameworks for dialogue, cooperation and monitoring of pro-

visions. Ideally, this leads to self-regulatory measures adopted by private actors and requires a high level of civil society engagement to ensure implementation of the labor and environmental clauses and remedies for violations (Ebert/Postuma 2011; Vogt 2015; Campling et al. 2015). This approach can be contrasted to a ‘conditional’ strategy, for instance pursued by the US in the now suspended TPP. Within TPP, the bilateral labor chapter negotiated with Vietnam obliged the parties to meet certain labor standards *before* the agreement would come into effect. While this ‘conditional’ approach can potentially strengthen domestic regulations in developing countries, there can be weak implementation and enforcement of those laws. Thus, trade unions and civil society actors become significant players in pressuring governments to uphold the enforcement of reforms.

As part of the comprehensive, UK Economic and Social Research Council-funded research project “Working beyond the Border: European Union Trade Agreements and Labour Standards”, Harrison et al. (2016a-b) analyze the performance of the EU approach to govern labor standards through the ‘new generation’ FTAs taking Moldova, South Korea and the CARIFORUM as case studies. Since TSD chapters share their key types of provisions (*substantive standards, procedural commitments and institutional structures*) across different agreements, Harrison et al’s conclusions – especially those for South Korea – give important hints to probable obstacles to the implementation of the provisions of the TSD chapter of the EVFTA. The authors set out three key problems (see also Barbu et al. 2017):

*i) Differing priorities*

While government officials from EU trading partners do not appear to see the externally imposed TSD chapters as their responsibility, the EC officials have prioritized the commercial dimensions of the trade agreements, attending only to the procedural obligations of the TSD chapters. Correspondingly, Ebert (2016: 426) notes with regard to labor standards and provisions that they “rank low on the parties’ political agendas”. Hence, much more efforts by EU officials is required.

*ii) Weak civil society capacity*

In the TSD chapters, the main burden of raising labor standards issues is assigned to the civil society mechanisms. These mechanisms are hampered by inadequate resourcing, infrequent meetings and limited influence upon the state-led committees to which they ultimately report. The EC (2017c) recently confirms this observation by stating that civil society structures have not been able to work to its full potential due to capacity constraints and the novelties it brings into being. Hence, support for civil society in partner countries and cooperation with EU civil society is required.

*iii) Insufficient targeting*

It is ill-suited to follow the same basic model, with limited variations, in all agreements, not taking into account the complexity of labor issues encountered within different countries. Pointing to South Korea for instance the appropriateness of an approach based on dialogue and cooperation is questioned, whilst the government cracks down on trade unions. Also Ebert (2016) underlines that it appears pivotal to make the application of the labor provision’s cooperation less dependent on the political good will of the parties and instead demand more specific legal requirements.

Overcoming these obstacles seems only possible if the aims of the TSD chapters will be clarified upfront in the future. Harrison et al. (2016a) see at least three (not necessarily) competing aims, which all call for different TSD approaches. If the aim of the TSD chapter



is (i) to utilize the trade agreement in order to take action against the worst labor violations in trading partners, whether or not these are trade related, then it should be scrutinized in detail, to which extent this is feasible with regard to each individual trading partner. If the aim is (ii) to understand and act upon the trade and labor nexus, then there is a need to monitor much more carefully what is actually happening under each agreement and devise instruments to manage implementation problems. However, if the aim is (iii) to tackle labor issues in global value chains – as suggested by pronouncements of DG Trade Commissioner Cecilia Malmström – then policy mechanisms must be based on a rigorous evaluation of how international trade regulations relate to different forms of transnational production. However, in this case it should be recognized that shifting the focus for labor issues onto corporations could deflect attention from the responsibilities of states.<sup>6</sup>

### 3.4. Development cooperation

Trade liberalization will likely cause adjustment costs, for instance in the form of revenue losses from tariff reductions or by leading to unemployment due to import competition. This will require support or adjustment assistance. On the other hand, the possibility to use the potential on the export side through improved and continuous market access to the EU will require specific policies and measures to increase Vietnamese exports to the EU. Development cooperation will therefore have an important role to increase exports through supply-side capacity building measures as productive capacities and capabilities are necessary to ensure export responses. But development cooperation also needs to play an important role to support the implementation of the EFVTA in itself as its implementation requires high legal, administrative and operational capabilities in the government and private sector. Finally yet importantly, development cooperation will be necessary to live up to the commitments agreed under the TSD chapter.

Chapter 16 on Cooperation and Capacity Building takes up these considerations partly. It affirms the importance of the efficient implementation of the agreement as a means to support the continued expansions of trade and investment activities between the parties and to create new opportunities for trade and investment (Article 1). The cooperation is to be carried out within the existing legal and institutional framework governing relations between the parties and takes the furthering of sustainable development in all its dimensions as the main objective (Article 2). The need for cooperation is not only stressed with reference to economic and trade-related aspects, but also with respect to sustainable development, “notably in its environmental and labour dimensions” (Article 2).

While exchanges of information, experience and best practices, as well as policy cooperation are listed as means of cooperation activities and the private sector is mentioned as an important player in this respect, nothing is said about the provision of financial resources to support the tasks at hand. This comes as a surprise, as the European Trade Policy and Investment Support Programme (EU-MUTRAP) has been in place since 1998. The current third programming period runs from August 2012 to the end of January 2018. The budget entails EUR 16.5 million, whereby the EU contributes EUR 15 million. The overall objective of the programme, which is executed and implemented by the Vietnamese Ministry of Industry and Trade (MOIT), is to further Vietnam’s integration into the global, ASEAN and sub-regional trading systems and to enhance EU-Vietnam trade and

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<sup>6</sup> On the 11 July 2017 the EC published a Non-paper of the Commission services on TSD chapters in FTAs to start a debate whether i) the current TSD chapters are meeting expectations, ii) a more assertive partnership should be pursued, iii) a sanction based approach would address the shortcomings identified and iv) any other issues need to be addressed (EC 2017c). Several scholars formulated collaboratively a response to this non-paper to reflect the range of scholarship on the EU model, which also serves as a reference for our assessment (Barbu et al. 2017).

investment relations. Support to the MOIT should be provided in facilitating sustainable international trade and investment through improved capacity for policy-making, policy consultation, and the negotiation and implementation of related commitments, particularly vis-à-vis the EU. The five envisaged results of the project mainly reflect the above-mentioned cooperation objectives of the EVFTA (MUTRAP n.d.b.):

- 1) EU-Vietnam trade and investment relations are strengthened through enhanced dialogue and co-operation, and the negotiation and implementation of a future EU-Vietnam FTA;
- 2) The institutional capacity for the negotiation and implementation of multilateral, regional and sub-regional trade commitments is strengthened;
- 3) Investment policy frameworks are improved, with a particular focus on the environmental and social issues in trade and investment related policies and legislation;
- 4) The access to information, regulations and market opportunities relative to Vietnam's international trade and investment commitments is improved with increased stakeholders participation in the trade and investment policy development process and enhanced capacity among SMEs to comply with European market access requirements; and
- 5) EU-Vietnam dialogue in economic areas of the Framework Agreement on Comprehensive Partnership and Cooperation (PCA) is supported, and flexible assistance is provided to address important urgent trade issues.

The EU-MUTRAP indicates that the EU recognizes Vietnam's needs in order to implement the EVFTA in an efficient and beneficial way, nevertheless the questions remains whether the allocation of the budget is sufficient in order to fulfil the highly demanding tasks. Even though the political and administrative capacities of Vietnam to implement the EFVTA can be considered as relatively high, not least with reference to the implementation of the TSD chapter additional financial resources would be reasonable and necessary to support monitoring activities.

However, the programming of the official development cooperation provided under the Multi-Annual Indicative Programme (MIP) for the period 2014-2020 seems to have been carried out independently from the negotiations of the EFVTA. The chosen focus sectors contain at best an indirect link to the EVFTA. EUR 346 million of the total amount of EUR 400 million is designated for supporting programmes in sustainable energy and EUR 50 million are provided for fostering governance and rule of law (EC 2014).

This missing link between EU development cooperation and the EVFTA, as well as the low budget allocation to MUTRAP have to be considered as an unused opportunity for strengthening the commitments particularly made under the TSD chapter, for addressing adjustment costs in import sectors affected by liberalization, and for ensuring that export potential can be used through capability building and upgrading support. Even though the TSD chapter within EFVTA is far reaching and comprehensive, the observation of Horn et al. (2009), that development cooperation in EU FTAs is often formulated in the form of unenforceable intentions, cannot be discarded in this case.

## 4. IMPLICATIONS OF EVFTA ON VIETNAM

The assessment of potential effects of the implementation of the EVFTA on Vietnam has four parts: First, the results of simulations with the ÖFSE Global Trade Model with regard to macroeconomic as well as sectoral changes due to the tariff liberalizations agreed in the EVFTA are reported and interpreted. Second, the general perceptions on the EVFTA including opportunities and constraints are discussed. Finally, two case studies on sectors that are expected to potentially profit from the EVFTA are presented, including a discussion on potential benefits and challenges. The sectors analyzed are textile and apparel as well as the fishery sector.

### 4.1. ÖFSE Global Trade Model: Simulation results for the EVFTA

#### 4.1.1. Description of methodology and calibration

The assessment of the economic effects of the EVFTA is based on the ÖFSE Global Trade Model, a structuralist Computable General Equilibrium (CGE) model. A detailed model description elucidating the differences to standard CGE models is provided in Box 1.

##### **Box 1: ÖFSE Global Trade Model: Methodology**

The applied ÖFSE Global Trade Model is a structuralist Computable General Equilibrium (CGE) model. The difference of this model to standard CGE models is the macroeconomic causality applied. In the ÖFSE Global Trade Model, output and income are determined by aggregate demand, rather than through a neoclassical clearing labor market. In other words, the underlying macroeconomic model is that of an income-expenditure framework, rather than a full employment model.

Standard, neoclassical trade CGE models presume to be based on microeconomic theory. Their focus lies on reallocation of economic activity across sectors instead of aggregate activity levels. Economic gains then emanate from productivity increases through such reallocation effects, in combination with price decreases. Similarly, they assume a constant public deficit, and thus do not assume revenue effects from trade policy changes – the public household is just an extension of the optimal allocation of the aggregate household. In consequence, standard CGE models speak neither to employment nor to public balance effects of trade policy, even though these are arguably of central importance.

The ÖFSE Global Trade Model seeks to address these weaknesses by shifting the focus. A multi-sectoral income-expenditure framework determines equilibrium in the goods market, and employment levels follow therefrom, given labor productivity changes. Wages, in turn, are functions of labor market tightness, and prices are mark-ups on intermediate, import and labor costs. In this sense, macroeconomic causality conforms to an AS/AD structure: first, demand determines output, and output drives employment; second, wages and prices are the outcome of bargaining in a non-clearing labor market.

Thus, a neoclassical model assumes a full employment steady state and focuses on sectoral reallocation, but does not claim to describe the adjustment path towards such an equilibrium. The income-expenditure framework, in contrast, assumes under-employment and focuses on demand effects, but does not claim to describe a full employment equilibrium. One could thus consider the resulting equilibrium as a medium-run Keynesian under-equilibrium that, at best, suggests adjustment costs on the path towards the ultimate new full employment equilibrium.

The model causality assumes that the immediate effect of policy and resulting price changes is a change in expenditures. Only in the very long run, and only if there are strong tendencies towards full employment steady states, does the reallocation equilibrium, supported by the necessary price changes, come about. When that happens, and whether it does, is not clear at all. Even though countries including Vietnam, are typically not in a liquidity trap, they are nowhere near a full employment steady state.

The simulation results depend on various factors including the production and trade structure, size and current tariff protection level of the economies and sectors involved in trade liberalization. A corollary of the assumed causality is that unilateral liberalization will tend to have negative effects as long as trade price elasticities are sufficiently high and one-sided price changes lead to an import surge that is not balanced by export or consumption increases. However, import price elasticities might be zero if imports (in a particular sector) are strictly complementary to domestic production. Under this assumption, the importing country would not respond at all to relative price changes on the import side. Then the aggregate effect of unilateral liberalization will tend to be positive, since the public balance deteriorates – implying an injection. On the aggregate level, zero elasticities are however not a realistic assumption for developing countries. We scrutinize the importance of elasticities for determining simulation results by way of sensitivity analysis.

See also Raza et al. 2016 for further details on the model.

The database for the assessment are multi-country data for the year 2011 provided by GTAP (Global Trade Analysis Project, Version 9), which allows for explicit modelling of the effects on bilateral trade flows due to changes in trade policies.<sup>7</sup> For this analysis, the model is calibrated for eleven countries and regions that cover all global economies and trade flows.

The regions for the EVFTA analysis include the EU, Vietnam (VIE), China (CHN), Japan (JPN), South Korea (KOR), all ASEAN countries and a group of other Asian countries (ASI). In addition, the United States (US), other OECD countries (OECD), Sub-Saharan African countries (SSA) and the Rest of the World (ROW) are included. For all countries/regions, 20 sectors are covered focusing on agri-food and manufacturing sectors. Based on the tariff liberalization schedules of the EVFTA all tariff reductions for the individual countries were estimated as trade-weighted changes to base year tariff levels (see Table 8; for sector aggregation of GTAP sectors see Table 1A in the Appendix).

The model simulations are based on changes in tariffs only. Other issues such as rules of origins and non-tariff measures (NTMs) are not explicitly included in the model.<sup>8</sup> Possible longer-run effects on Vietnam such as higher investment induced by the agreement, development cooperation efforts to improve trade-related capacities and capabilities or pressure on broader reforms in Vietnamese economy triggered by the agreement are not part of the analysis. Also potentially negative effects such as reduced policy space to support export sectors and broader structural transformation in the country are not covered by the model. A further limitation of the simulations, as in most CGE models, is that effects of

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<sup>7</sup> The base year data are not projected to a future year, as we focus on reporting percentage changes.

<sup>8</sup> The issue of NTMs is part of the EVFTA, however, the modelling of NTM effects on trade in goods and services would require additional information and assumptions, in particular for NTMs in agricultural and manufacturing goods. Most importantly, the economic effects of NTM reductions are most likely less significant on the macro level as trade in services play a minor role in the trade relations between EU and Vietnam.

tariff reductions on products with low or no trade flows are underrepresented due to the use of past trade data. The simulation results should therefore be carefully interpreted.

Table 7 shows the trade patterns between Vietnam and the EU on a sectoral basis and the level of tariffs applied against imports on each side. The tariff protection weighted by import shares is similar in both trading partners with around 4%. However, protection in agricultural sectors is generally higher in Vietnam. In addition, selected manufacturing sectors in Vietnam are highly protected (for instance motor vehicles) while imports of manufacturing goods from Vietnam into the EU face already very low tariff barriers.

Based on the tariff liberalization schedule in the EVFTA, the tariff reductions per sectors are reported in Table 7. The weighting by import share shows that effects from tariff reductions can be expected on Vietnam's import side in the sectors chemicals, machinery and other manufacturing. On the EU side, changes in import tariffs on textiles, apparel and footwear are most relevant.

*Table 7: Sectoral Overview and Tariff Reductions EU-Vietnam*

|                      |                    | VIE             |              |                  |            | EU              |              |                  |            |
|----------------------|--------------------|-----------------|--------------|------------------|------------|-----------------|--------------|------------------|------------|
|                      |                    | Import share    | Tariffs      | Tariff reduction |            | Import share    | Tariffs      | Tariff reduction |            |
|                      |                    | (from EU, in %) | Base year    | in %*            | Share*     | (from VIE in %) | Base year    | in %*            | Share**    |
| 1                    | Cereals (cer)      | 0.1             | 0.1          | 100              | 0          | 0.0             | 3.8          | 90               | 0          |
| 2                    | VegFruit (v_f)     | 0.0             | 15.5         | 100              | 0          | 1.0             | 0.5          | 99               | 2          |
| 3                    | otherAgri (oag)    | 0.4             | 1.0          | 85               | 1          | 0.2             | 1.6          | 98               | 0          |
| 4                    | OtherCrops (ocr)   | 0.2             | 16.9         | 75               | 0          | 7.8             | 0.0          | 100              | 0          |
| 5                    | Fishery (fsh)      | 0.0             | 8.1          | 100              | 0          | 0.1             | 2.4          | 100              | 0          |
| 6                    | Commodities (com)  | 0.5             | 0.8          | 95               | 1          | 0.2             | 0.0          | 100              | 0          |
| 7                    | Meat (mea)         | 0.8             | 6.1          | 100              | 1          | 0.0             | 8.1          | 100              | 0          |
| 8                    | Dairy (dai)        | 0.9             | 4.4          | 100              | 1          | 0.0             | 23.0         | 100              | 0          |
| 9                    | Foods (fds)        | 3.9             | 13.8         | 100              | 6          | 7.5             | 6.8          | 98               | 13         |
| 10                   | Beverage (b_t)     | 1.1             | 28.8         | 100              | 2          | 0.3             | 14.3         | 100              | 1          |
| 11                   | Textiles (tex)     | 2.0             | 10.5         | 100              | 3          | 3.4             | 7.6          | 100              | 6          |
| 12                   | Apparel (app)      | 0.3             | 19.4         | 100              | 0          | 10.8            | 9.2          | 100              | 19         |
| 13                   | Footwear (fsh)     | 1.4             | 10.2         | 100              | 2          | 19.3            | 10.7         | 100              | 33         |
| 14                   | Wood (wod)         | 0.5             | 6.4          | 100              | 1          | 5.5             | 0.0          | 100              | 0          |
| 15                   | Chemicals (che)    | 13.3            | 3.2          | 100              | 20         | 4.3             | 0.8          | 100              | 7          |
| 16                   | MotorVehicle (mvh) | 2.8             | 21.0         | 100              | 4          | 0.2             | 0.1          | 100              | 0          |
| 17                   | Machinery (mac)    | 20.7            | 2.5          | 100              | 30         | 3.4             | 0.1          | 100              | 6          |
| 18                   | Electronics (ele)  | 1.6             | 2.2          | 100              | 2          | 16.0            | 0.0          | 100              | 0          |
| 19                   | OtherManu (oma)    | 17.6            | 6.6          | 100              | 26         | 8.0             | 0.6          | 100              | 14         |
| 20                   | Services (ser)     | 31.8            | 0.0          | -                |            | 12.0            | 0.0          | -                | 0          |
| <b>Sum</b>           |                    | <b>100</b>      |              |                  | <b>100</b> | <b>100</b>      |              |                  | <b>100</b> |
| <b>Average</b>       |                    |                 | <b>8.9</b>   |                  |            |                 | <b>4.5</b>   |                  |            |
| <b>Weighted Avg.</b> |                    |                 | <b>4.2**</b> | <b>99.8</b>      |            |                 | <b>4.0**</b> | <b>99.8</b>      |            |

Notes: Import share, import price elasticity and tariffs are derived from GTAP database. Tariff reductions based on own estimations. \*Tariff reduction in percent compared to current tariff rate. \*\*Trade-weighted by import shares

Source: GTAP database and own calculations

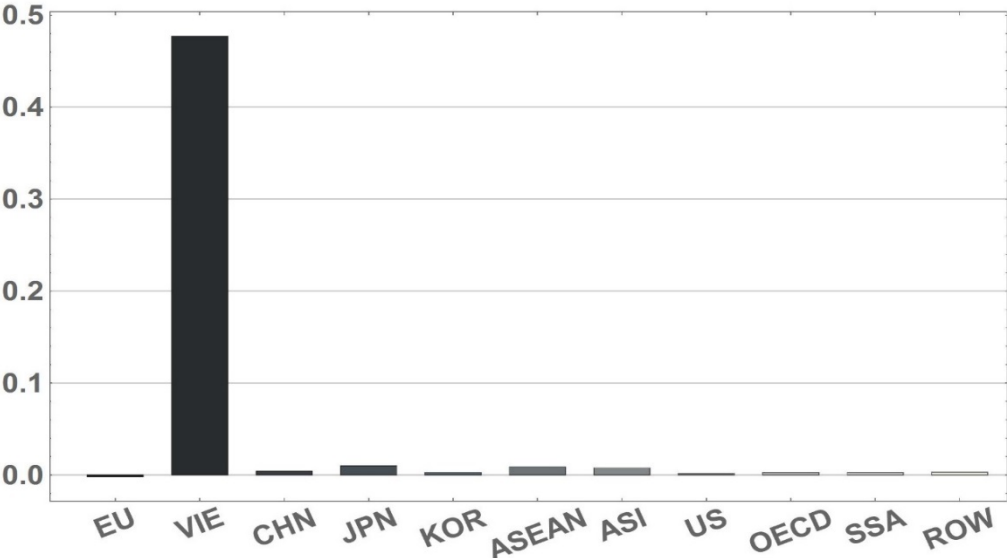
### 4.1.2. Macroeconomic results

The main macroeconomic results from the model simulations focus on the changes in real GDP and the contributions to these effects based on the income and the expenditure approach. Most importantly, the reciprocal and full tariff liberalization increases bilateral trade flows. However, Vietnam benefits significantly more from the tariff reductions due to the trade surplus and the sectoral trade patterns with the EU. In addition, the size effects play an important role, given the difference in the economic size (in terms of GDP) between the EU and Vietnam.

#### Growth of country real GDP

Figure 2 shows model output in the aggregate on a country (or region) level for the tariff reduction schedule in the EVFTA. Each bar represents the real GDP growth rate of the country. Thus, Vietnam’s real GDP increases by 0.48%, while the real GDP of the EU remains basically unchanged. Asian trading partners benefit slightly, for instance Japan and ASEAN countries by 0.01%, while all other countries and regions are hardly affected by the EVFTA.

Figure 2: Growth of country real GDP



Source: CGE calculations

Vietnam’s real GDP increases because tariff liberalization on both sides leads to a surge in Vietnam’s exports to the EU. This creates a positive contribution to aggregate demand and therefore income for production factors and ultimately more consumption in Vietnam. This is also supported by lower tariffs, which decrease firm’s (non-factor) costs, and thus lead to a ceteris paribus increase in real incomes of households. The counteracting effects of a replacement of domestic production by higher imports from the EU due to lower tariffs, is less relevant in the aggregate. However, GDP in single sectors in Vietnam is negatively affected by liberalization and increased imports (see below).

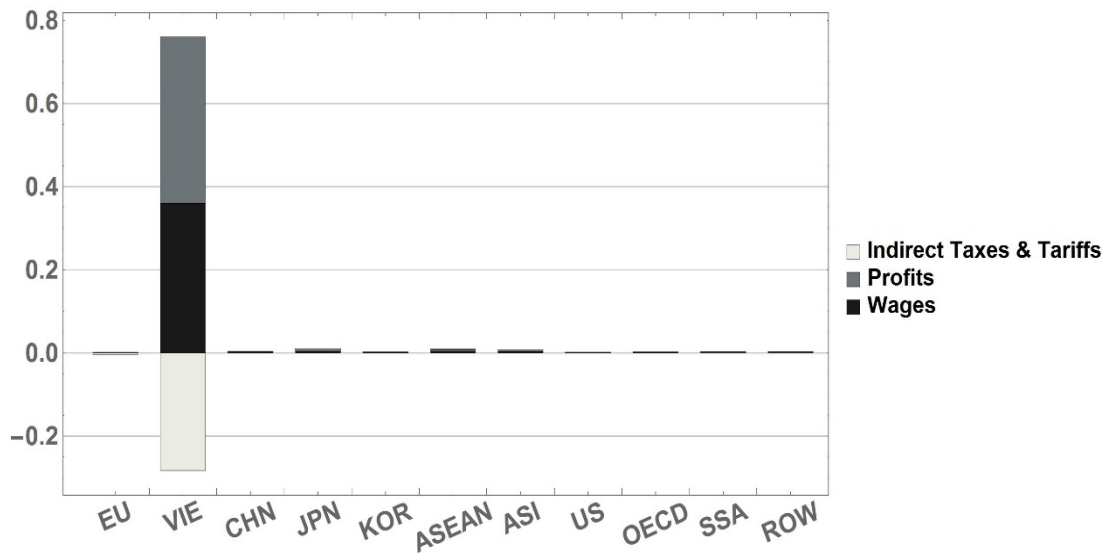


### Growth contributions of incomes and expenditures

Figure 3 and Figure 4 contain the same information as Figure 2 but differently presented. GDP can be decomposed either into incomes – private and public – or expenditures – consumption, public expenditures, investment, and net exports. Thus, the sum of all components in Figure 3 and Figure 4 are identical to the changes in real GDP shown in Figure 3.

Figure 3 represents the income decomposition, where private incomes are the sum of total wages and profits, and public income are indirect taxes and tariffs. The black portion of the bar (0.36%) represents the contribution of wages to total growth, which is defined as the product of the share of the wage bill in GDP and the growth of the wage bill.<sup>9</sup> The dark gray portion of the bar (0.40%) represents the growth contribution of profits. The light gray (-0.28%) shows changes in production taxes and tariffs, mainly reflecting the effects of foregone income from tariff reductions. The three components sum to 0.48%.

Figure 3: Growth of country real GDP (income side)

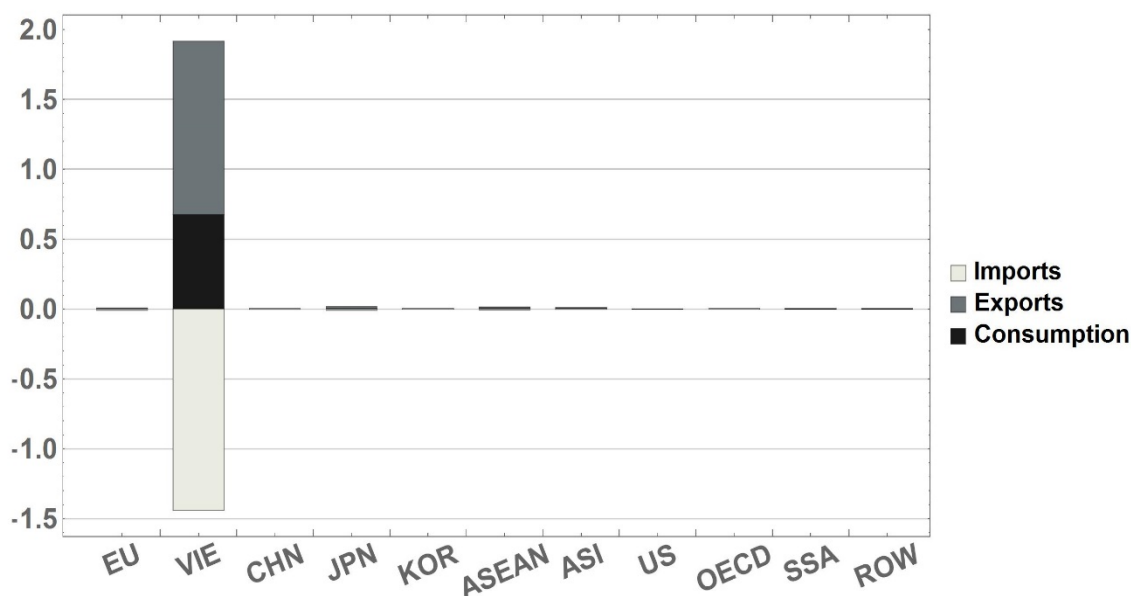


Notes: Decomposition of growth from the income side. Black represents growth contribution of total wages, dark gray profits, and light gray indirect taxes and tariffs.

Source: CGE calculations

<sup>9</sup> Note that all components are deflated by the GDP deflator.

Figure 4: Growth of country real GDP (expenditure side)



Notes: Decomposition from the expenditure side. Black represents growth contribution of real consumption, dark gray real exports, and light gray real imports.

Source: CGE calculations

Analogously, Figure 4 shows the growth contributions of the endogenous components of demand: black represents consumption (0.68%), dark gray exports (1.24%) and light gray imports (1.44%). Again, the sum is 0.48%.

In the EU, the single components of real GDP are almost unchanged. Increased exports contribute slightly (+0.01%), however this is counterbalanced by more imports (-0.01%).

These decompositions highlight the above mentioned causal linkages. Private income in Vietnam, wages and profits, increases more than public income declines as exports and consumption cause a surge in factor demand. Since however the contribution of total net exports are negative due to more imports from other Asian countries (mainly China), the expansion of consumption due to higher household income leads to an overall positive effect for Vietnam.

### Effects on trade flows

As highlighted in Figure 4, changes in imports and exports are the main drivers of changes in real GDP. With the EVFTA, the bilateral trade flows between the EU and Vietnam increase. As Table 8 shows, exports from the EU to Vietnam increase by 7.27%, however, total EU exports hardly change given that Vietnam is a small trading partner of the EU accounting only for 0.5% of total extra-EU exports (first row). On the other hand, exports from Vietnam to the EU increase by 7.18%, which leaves total EU imports virtually unchanged but increases Vietnam's total exports by 1.51% given the high importance of the EU with a share of 20% in the total exports of Vietnam. Importantly, the increasing exports to the EU also trigger an increase in Vietnam's imports from its major trading partners in Asia and other regions, leading to higher total imports (+ 1.47%). This owes to the fact that Vietnam's main exports to the EU depend on imported inputs from other countries in the Asian region, the latter being most pronounced in electronics, apparel and footwear.



Table 8: Changes in inter-regional trade flows, EVFTA

|                   | EU           | VIE          | CHN   | ASEAN | other Asian | US    | all other regions | Total        |
|-------------------|--------------|--------------|-------|-------|-------------|-------|-------------------|--------------|
| EU                | 0.00%        | <b>7.27%</b> | 0.00% | 0.01% | 0.01%       | 0.00% | 0.00%             | 0.01%        |
| VIE               | <b>7.18%</b> |              | 0.01% | 0.01% | 0.02%       | 0.00% | 0.00%             | <b>1.51%</b> |
| CHN               | -0.03%       | 0.99%        |       | 0.01% | 0.01%       | 0.00% | 0.00%             | 0.01%        |
| ASEAN             | -0.01%       | 0.75%        | 0.01% | 0.01% | 0.01%       | 0.00% | 0.00%             | 0.02%        |
| other Asian       | -0.02%       | 0.93%        | 0.01% | 0.02% | 0.01%       | 0.01% | 0.00%             | 0.02%        |
| US                | 0.01%        | 0.78%        | 0.01% | 0.01% | 0.01%       |       | 0.00%             |              |
| all other regions | 0.00%        | 0.78%        | 0.01% | 0.01% | 0.01%       | 0.00% | 0.00%             | 0.01%        |
| Total             | 0.02%        | <b>1.47%</b> | 0.01% | 0.01% | 0.01%       | 0.01% | 0.00%             |              |

Notes: Exporting countries/regions are in the first column and importing countries/regions in the following columns. Thus, exports from the EU to Vietnam increase by 7.27% or respectively imports by Vietnam from the EU increase by 7.27%.  
Source: CGE calculations

### Changes in macro balances

In contrast to standard CGE models, the ÖFSE Global Trade Model includes changes in important macroeconomic balances, namely the change in net exports (foreign balance), the change in the private balance and the change in the public balance, all relative to GDP.

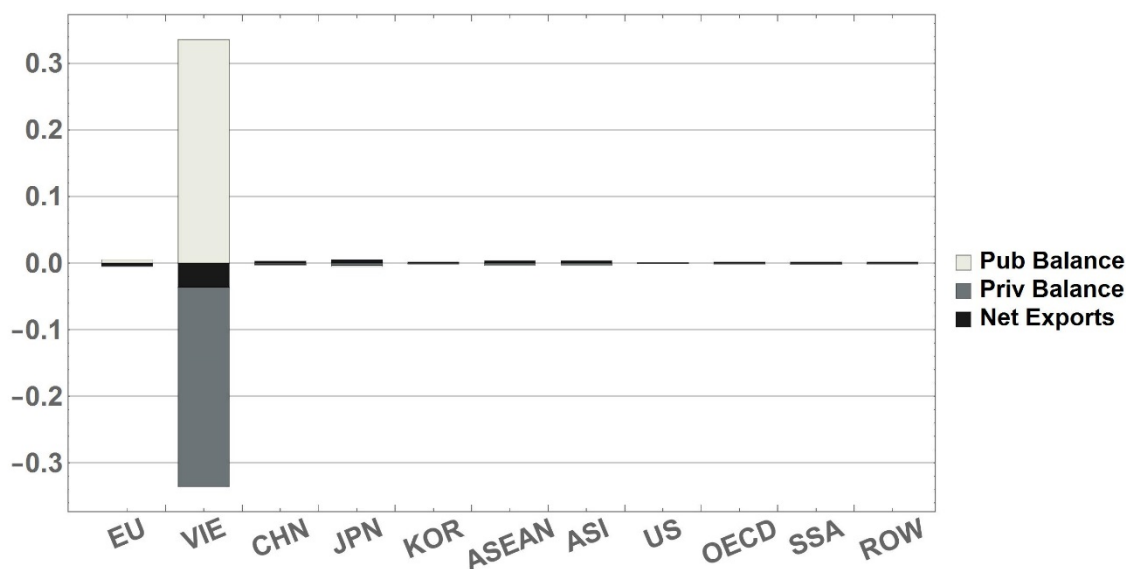
Figure 5 shows aggregate country results from a different perspective. Model equilibrium in the market for goods and services occurs when demand is equal to supply. An equivalent way of saying the same thing is that all demand injections equal leakages, or, more specifically, that the sum of the differences between injections and leakages of private, public and foreign 'institutional sector' is equal to zero.

In other words, both before and after the application of the liberalization scenario, the sum of net exports or the *foreign balance* (E-M, black), the *private balance* (I-S, dark gray) and the *public balance* (G-T, light gray) is zero. Note that the public balance is the negative of the public deficit. Following convention, the balances are defined as difference between injection and leakage, thus determining a *net borrowing flow* of the institutional sector.<sup>10</sup>

Figure 5 shows the *changes* in these balances, normalized by pre- and post-liberalization GDP. Since the pre- and post-liberalization sum of the balances is zero, the sum of these changes will be zero as well. The change in net exports relative to GDP is slightly negative (-0.04%) as the initially negative trade balance deteriorates by a minor degree. The change in the private balance relative to GDP is -0.30% and the change in the public balance 0.34%. Thus, lost tariff revenue creates a public deficit as this revenues loss is not compensated by other tax income despite the higher economic activity in Vietnam. As household incomes increase, higher private savings are available to finance most of the higher public deficit.

<sup>10</sup> In the case of a trade deficit, the foreign sector has negative net borrowing, which is equivalent to net lending from the rest of the world to the country under consideration. Note further that in the foreign balance both expenditure components are endogenous, but that in private and public balance only leakages are endogenous – public expenditure G and firm investment I are held constant.

Figure 5: Change in sectoral balances relative to GDP



Notes: Black represents the change in net exports relative to GDP, dark gray the change in private balance relative to GDP, and light gray the public balance relative to GDP. Each balance is defined as a net borrowing flow, i.e. the difference between injections and leakages.

Source: CGE calculations

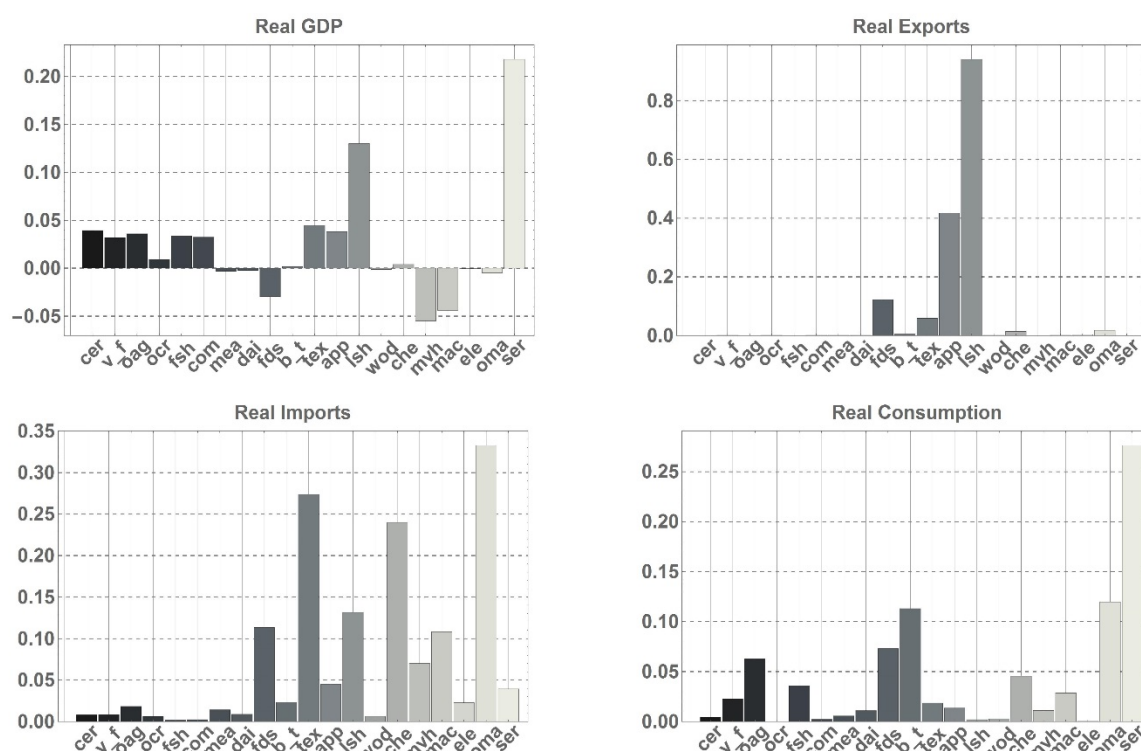
In summary, across Figures 2 to 5, the results suggest that Vietnam benefits from the EVFTA due to various factors. Lower tariffs decrease firm's (non-factor) costs, and thus lead to a ceteris paribus increase in real incomes of households. Most importantly, the resulting surge in imports does not reduce factor demand in the aggregate. On the contrary, changes in exports create sufficient factor demand in Vietnam that increases household income and therefore consumption. The driving factor in Vietnam is the increase in wage and profit income on the income side, and the consumption effect on the expenditure side.

#### 4.1.3. Sectoral results

Figure 6 and Figure 7 report sectoral results for Vietnam according to the allocation described in Table 1A in the Appendix. In Figure 6, changes in real GDP, total exports and imports as well as consumption are presented as weighted changes. Thus, the sum of all bars in each single figure equals the changes reported above. In the case of GDP, the sum across the bars in the top left panel is the growth rate of GDP, namely 0.48% known from Figure 2 to 4.

The remaining panels show related statistics on the sectoral expenditure side. The top right, for example, records the sectoral contributions to the growth of aggregate real exports. In other words, each bar represents the product of the share of sectoral real exports in total real exports and the growth rate of those sectoral real exports. These aggregate growth rates are 1.51% for real exports, 1.47% for real imports (compared also to Table 8) and 0.68% for real consumption.

Figure 6: Sectoral contributions to growth in Vietnam



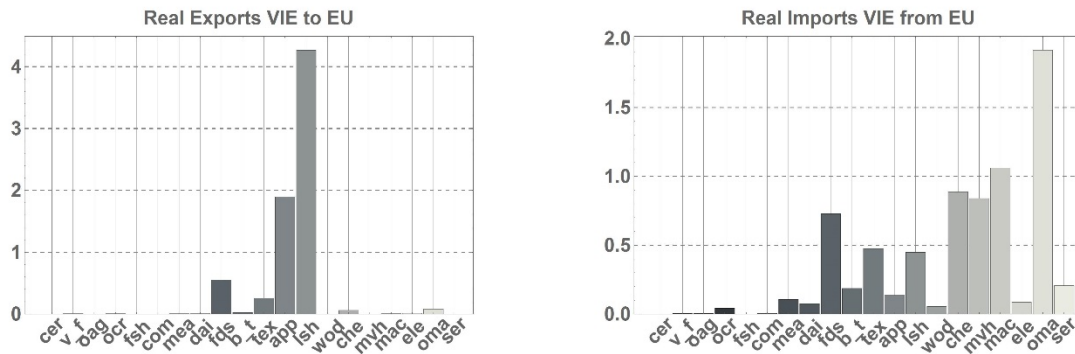
Notes: Top left: Each bar represents the sectoral contribution to growth of real GDP. The sum across sectors amounts to 0.48%, see the bar for Vietnam in Figure 2. Top right: Each bar represents the sectoral contribution to growth of real exports. The sum across sectors is the aggregate growth rate of real exports (1.51%). Bottom left: Sectoral contributions to growth of real imports; aggregate 1.47%. Bottom right: Sectoral contributions to growth of real consumption (0.68%). Source: CGE calculations

Various issues are important on a sectoral level. The changes in total exports from Vietnam are concentrated in only a few sectors – leather and footwear, textiles and apparel, and food, while changes in total imports are more diverse. Here, the most affected sectors are other manufacturing, textiles, leather and footwear, and food.

Changes in real GDP and consumption are dominated by changes in the service sector, which is not directly affected by tariff reductions. However, multiplier effects are crucial in this case given that almost 40% of consumption is spent on services in Vietnam. Thus, services as intermediate inputs and as part of private consumption benefit from positive production and consumption effects. Beyond the service sector, there are gains in real GDP in the textiles and apparel and leather and footwear sectors due to higher exports and positive changes in several agricultural sectors due to consumption effects. However, there are a number of sectors that show negative GDP effects. For instance, real GDP in motor vehicles, machineries and food as well as meat and dairy declines due to replacement of domestic production by imports.

A detailed presentation of changes in bilateral trade in Figure 7 reveals again the concentration of higher exports from Vietnam to the EU in only four sectors of the economy and in particular in footwear and apparel. Imports from the EU to Vietnam increase largely in industrial sectors. As previously, the sum of the bars in the two panels equal the changes in bilateral trade flows reported in Table 8.

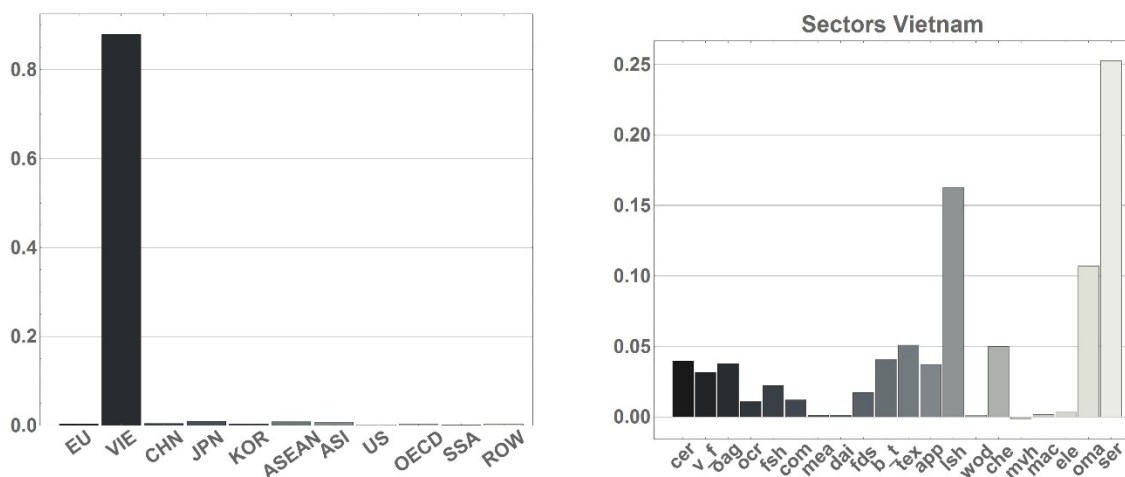
Figure 7: Bilateral Trade Flows EU-Vietnam



Notes: Left panel shows changes in real exports from Vietnam to the EU; the right panel shows changes in real imports from the EU to Vietnam  
Source: CGE calculations

Similar to the sectoral changes in GDP, changes in employment are concentrated in the service sector, apparel, footwear and selected agricultural sectors. These labor intensive sectors contribute to the positive overall change in employment in Vietnam, which amounts to 0.88% (left panel of Figure 8) and thus is even stronger than the change in real GDP.

Figure 8: Employment Growth



Notes: Left panel shows aggregate employment growth in all regions. Right panel shows sectoral contributions to aggregate employment growth in Vietnam. The sum across sectors at right is equal to Vietnam's bar in the left panel.  
Source: CGE calculations

#### 4.1.4. Sensitivity Analysis

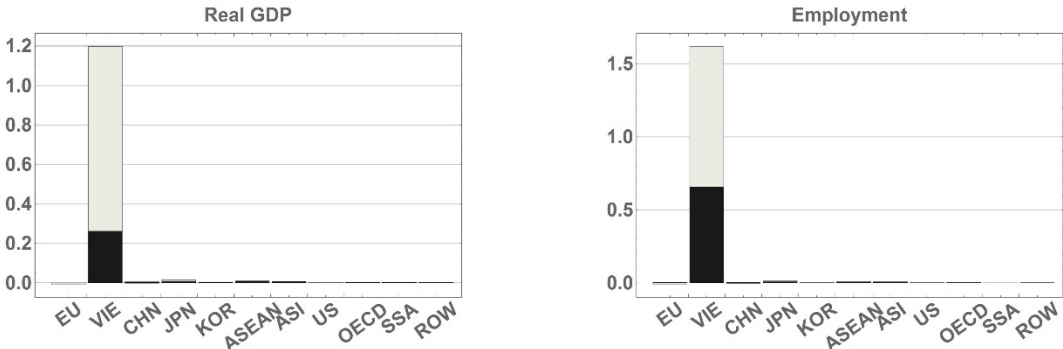
Figure 9 presents sensitivity analysis. The purpose of sensitivity analysis is to assess to what degree model results depend on parameter values, which are often subject to significant uncertainty. Here, we focus on import price elasticities: the elasticity that describes the percentage change in real imports in response to a percentage change in relative prices. Traditionally, but also in our model, these elasticities are exogenous inputs into the model and have a significant effect on the magnitude of the estimated effects. The elasticities applied in our model (as discussed above) are from the GTAP database, and are, following standard practice, uniform across countries but vary across sectors.

These so-called “Armington elasticities” are often viewed critically on the grounds that they are unreasonably large. The unweighted average of the GTAP elasticities in our aggregation is 3.2, with elasticities around four in sectors such as *leather and footwear* and *machinery*. For our baseline calibration, which is used to produce model results previously discussed, we therefore feed only half the GTAP value into the model, for an unweighted elasticity average of 1.6. In the case of Vietnam, the average elasticity vis-à-vis the EU, weighted by import shares, then amounts to 1.5.

Now, to conduct sensitivity analysis, we, first, further reduce the average elasticity values, and, second, increase them. Figure 9 presents these results. The low elasticities correspond to 1/3 of GTAP values, the high elasticities to full GTAP values. The black bar shows the growth rate of real GDP with low elasticities, and the gray bar shows the *additional change* with high elasticities. Thus, for Vietnam, the left panel records a real GDP expansion of 0.26% with low elasticities, and 1.20% with high elasticities. The right panel illustrates the concomitant growth rate of real employment, which ranges from 0.66% to 1.62%.

The ranges represented in Figure 9 are indicative of the uncertainty surrounding estimates of the effect of liberalization. The outcomes of EVFTA simulations depend crucially on trade effects in specific sectors, particularly exports in apparel (app) and footwear (lsh) and on imports in manufacturing sectors. Thus, elasticities are important factors to determine trade responses following changes in tariffs and subsequently overall effects.

Figure 9: Sensitivity analysis



Notes: The left chart shows model results for different trade price elasticities. The black (gray) bar corresponds to 1/3 (full) of GTAP trade price elasticities. The unweighted average of trade price elasticities across sectors is 1.01 (3.04); for our baseline scenario with half the value of GTAP elasticities the unweighted average is 1.60. The size of the gray bar is inclusive of the black. For example, Vietnam’s real GDP increases by 0.26% with 1/3 of elasticities, but surges to 1.20% with full elasticities. The right panel shows the corresponding results for aggregate employment. Source: CGE calculations

4.1.5. Comparison and Conclusions

Our simulations show that the bilateral tariff liberalization is positive for Vietnam with regard to aggregate real GDP and employment. The export sectors benefiting the most from the tariff free access to the large EU market are leather and footwear as well as textiles and apparel. The positive effects are also based on multiplier effects that are particularly relevant for the service sector. Given the labor intensity of these sectors, employment effects of the EVFTA are positive.

Beneficial outcomes for Vietnam are also reported in other studies on the economic effects of an EVFTA, but the magnitude of these macroeconomic effects is significantly higher compared to our results. The two most important studies in this regard are ECORYS 2009 and Baker et al. 2014. Generally, model results differ due to type of models (CGE, Partial

Equilibrium), model causalities, datasets, time frames and liberalization scenarios and should therefore be compared with caution. For instance, ECORYS (2009) conducted a Sustainable Impact Assessment for a trade agreement with ASEAN and not Vietnam specifically. However, the standard CGE models applied by the two studies (see also Box 1 for further details) elevate trade and GDP effects of the EU Vietnam FTA drastically, with ECORYS (2009) reporting GDP changes in Vietnam of more than 15% and Baker et al. (2014) estimating an additional GDP growth up to 8% for Vietnam. Most importantly, this strong GDP growth goes along with sectoral shifts in Vietnam from high-value manufacturing sectors such as machinery and motor vehicles where a 30% output loss is estimated according to ECORYS (2009: 28) to labor-intensive manufacturing such as apparel and footwear where output increases of 14% and 121% are estimated. Thus, current production and trade patterns in Vietnam that focus on labor-intensive and rather low value added sectors would be reinforced.

In our simulation, manufacturing sectors other than textiles and apparel and the food sector see also declines in real GDP due to the replacement of domestic production by EU imports. Trade in agricultural and food products is affected only to a small degree. In addition, the tariff liberalization deteriorates the public balance as tariff revenues on EU products are completely eliminated. However, with 0.31% of GDP the size of the effect on the public balance remains rather small.



## 4.2. General perception of the EVFTA in Vietnam

Until recently, the discussion on the EVFTA in Vietnam has been overshadowed by the prospect of TPP. The public debate on and perceived importance of the EVFTA has increased since the conclusion of the TPP became unlikely. The public debate on the EVFTA in general nonetheless has been limited since local civil society organizations lack capacities and capabilities to fulfill their critical function and assess the potential consequences of policies such as FTAs and/or lack the channels to communicate their concerns to the public in a meaningful way.

Our interviews, conducted with representatives of government agencies, business associations, the labor union and other relevant local and international actors in Vietnam clearly suggest that the EVFTA is perceived as an opportunity for export growth, economic development and – in part – a potential trigger for economic and political reform. The ‘complementarity’ of the EU and Vietnamese economies is the key reason why the EVFTA is believed to bring predominantly positive effects for Vietnam and why negative effects are expected to be rather small.

The reduction in tariffs is by far the most important content of the EVFTA that is believed to be beneficial for the Vietnamese economy. The key export sectors to the EU with comparatively high GSP tariffs (such as the T&A, footwear and fish sectors) are expected to be the key beneficiaries of the EVFTA (Table 9). Expectations on increasing FDI inflows are moderate due to the existing BITs; the reformed ISDS is seen as a necessary compromise by government officials and is particularly criticized by international NGOs based in Vietnam who oppose the inclusion of an ISDS mechanism in the EVFTA in general. Other potential benefits, such as improved market access to government procurement, cross-border services and investments in the EU play a comparatively small role in the expectations of potential benefits.

The interviewees have nonetheless mentioned several key challenges in order to benefit from the EVFTA. A major concern is the utilization of preferential tariffs due to strict RoO as well as limited possibilities (e.g. due to specific value chain dynamics), capacities and capabilities to comply with their requirements. The interviewees have pointed out, however, that huge differences in capacities and capabilities exist between and within sectors, with larger companies and more export-oriented sectors generally having less problems to fulfill RoO. The relatively strict RoO in the EVFTA will hamper utilization rates in the short term; however, they might also incentivize upgrading for example in the T&A sector (see section 4.3.). Low utilization rates (24-34% in value) of Vietnamese exports have been observed in the context of other FTAs with ASEAN, China, Australia and New Zealand, Japan and India (Thưong 2016). The importance of capacity and capability building in this regard can be seen in the case of the FTA with Korea, in which utilization rates were raised from similar levels to 57% in a few years, in particular due to buyers’ engagement. The EU project MUTRAP (and ARISE+ starting in 2018) has been praised in this regard; however, bottlenecks are expected in sectors with less export orientation compared to the T&A, footwear, fisheries and electronics sectors. The utilization rates of Vietnamese exports to the EU will thus have to be carefully monitored in order to tackle potential (sectoral) bottlenecks.



Table 9: EVFTA tariff effects on key export products

| HS | Goods   | EU-VIE Imports<br>(million EUR) | EVFTA<br>tariffs | GSP (% , 2016) |
|----|---|---------------------------------|------------------|----------------|
| 85 | Electrical machinery and equipment              | 12,742.72                       | 0                | 0.1            |
| 84 | Machinery                                       | 3,995.15                        | 0                | 0              |
| 64 | Footwear  | 3,709.80                        | 0                | 8.9            |
| 62 | Apparel and clothing (not knitted or crocheted) | 2,082.28                        | 0                | 9.0            |
| 09 | Coffee, tea, mate and spices                    | 1,483.42                        | 0                | 0.1            |
| 94 | Furniture                                       | 1,023.89                        | 0                | 0              |
| 61 | Apparel and clothing (not knitted or crocheted) | 916.75                          | 0                | 9.4            |
| 42 | Leather bags                                    | 770.14                          | 0                | 1.5            |
| 08 | Edible fruit and nuts                           | 693.50                          | 0                | 0.2            |
| 03 | Fish  | 659.87                          | 0                | 6.0            |
| 39 | Plastic and articles thereof                    | 545.37                          | 0                | 1.6            |

Notes: Trade weighted GSP tariffs based on WTO and Eurostat data

Source: Eurostat 2017; WTO 2017

Another key issue for Vietnamese exporters are comparatively high private and public European standards related to SPS and TBT issues, the environmental and social impact of production and other sector specific demands in various sectors. The difficulty as well as capacities and capabilities to fulfill buyers' demands vary wildly between sectors and heavily depend on specific value chain dynamics. The difficulty to fulfill buyers' demands decreases with the control exerted by key actors (such as processors and exporters) over the chain as well as with increasing vertical integration (see e.g. the comparison between the shrimp and pangasius sector in section 4.4.).

The potential of local industry displacement due to increased imports from the EU is expected to be small, since the EU and Vietnamese economies are considered largely complementary. Interviewees furthermore pointed out that ASEAN tariff liberalization will be much more important in this regard. Some interviewees nonetheless raised the concern of potentially increasing imports of specific products and services, such as agricultural and food products (e.g. wheat or meat). The increase in competition, furthermore, was also perceived as a chance than as a threat, since Vietnamese companies will have to enhance their performance and efficiency in order to compete with European companies.

Policy space reductions incorporated in the EVFTA in general are not only perceived as a 'necessary' part of FTAs, but also as driver for reform. In general, the pro-economic reform forces within the Vietnamese political system try to leverage policy space reductions of the EVFTA to promote reform on various levels. The policy space reductions of the EVFTA, however, are comparatively less important compared to WTO commitments. The key policy space reductions of the EVFTA include the (partial) liberalization of tariffs, services, public procurement and investments, the promotion of transparency in the SOE sector, the extension of equal legal treatment to private companies with respect to SOEs and the increasing pressure for labor rights reform. Reformist social forces to some extent include social groups with contradictory interests, most importantly parts of the private business sector and organized labor. Reformists in the business sector particularly hope that the EVFTA will improve the business environment in general and reduce the power of SOEs

in Vietnam. Reformists more closely related to the interests of labor try to leverage the EVFTA to improve labor rights in Vietnam.

The sustainability chapter of the EVFTA directly relates to the recent discussion in Vietnam on labor rights reform. The Vietnamese government agreed on initial reforms on freedom of association, collective bargaining and minimum work conditions in the context of TPP negotiations, since the USA made the conclusion of TPP with Vietnam contingent upon the labor rights reform. After the conclusion of TPP became unlikely because of the changing position of the new US administration, discussions in Vietnam on the labor rights reform intensified but it has yet to be seen if and how the reform will be implemented without the pressure of the TPP. Since the conclusion of the EVFTA is not contingent upon the more comprehensive reforms discussed in the sustainability chapter (see section 3.3.) and the EU aims to further reforms in the medium-term via mechanisms for dialogue, the pressure for the Vietnamese government to implement labor right reform has been alleviated.

During field research, reformists more closely aligned with the interests of labor expressed their hopes as well as concerns with regard to the recent developments, in particular with regard to freedom of association. On the one hand, the decreasing reform orientation of the Vietnamese government is seen as problematic and as a direct outcome of the failure of TPP as well as the more dialogue-oriented approach of the EU. Some interviewees argued that the EU approach will most likely have little impact on reform, as the experience with the EU-Korea FTA has shown. On the other hand, it was argued that the reform of freedom of association might decrease the power of labor if not done right, since newly established labor unions might have difficulties to organize and represent the interests of labor while the incumbent and powerful single trade union will lose its power. This might be particularly true in case of the establishment of a multitude of labor unions during a short period of time and the establishment of yellow unions that do not reflect labor's interests. Furthermore, it was critically mentioned that the US approach 'enforces' reforms in Vietnam in a prompt and coercive manner and is thus also more likely to trigger the above mentioned potential organizational issues of labor unions. The EU approach adopted in the EVFTA is however only perceived as a viable alternative in case reforms are actually promoted and the intentions expressed in the sustainability chapter do not remain an empty promise.

### 4.3. CASE STUDY I: Textile and Apparel Vietnam

The textile and apparel (T&A) sector is expected to be one of the main winners at the export side in Vietnam in the context of the EVFTA. Tariffs are relatively high in the EU and also in Vietnam and will be reduced to zero within a maximum of ten years, combined however with restrictive RoO. Hence, analysing the sector is relevant regarding tariff reductions in combination with RoO as well as regarding potential implications on regional trade flows as cumulation is only allowed with Korea based on the existing EU-Korea FTA and not with ASEAN member countries. Further, the potential implications of the sustainability chapter are relevant in the context of often very problematic working conditions in the apparel sector globally and in Vietnam.

The sectorial case study of the T&A sector in Vietnam also shows the importance of specific sector and value chain dynamics as well as local conditions in being able (or not) to use market access potentials provided through FTAs on the export side. To understand the development implications of the EVFTA for Vietnam's T&A sector, it is first crucial to analyse the regulatory changes the EVFTA has brought. But the analysis of regulatory changes has, secondly, to be done in combination with assessing competitive business dynamics within the T&A GVC and particularly the sourcing and investment strategies of lead firms/buyers and foreign investors to understand potentials and limitations for export responses. Thirdly, local conditions clearly have a large impact on the possibilities to use the export potential of the EVFTA. In this regard specifically the fabric-forward RoO (double transformation) are challenging to be fulfilled by Vietnamese apparel exports that currently largely depend on imported textile inputs. Also fulfilling requirements of the sustainability chapter will be a challenge if the two governments take the chapter serious and push for its implementation. These issues highlight the importance of sector-specific support policies and the important role of development cooperation in capability building in production as well as in labor and environmental standards compliance.

This section starts with an overview of the global T&A sector, highlighting key organizational and regulatory dynamics, and of the development of the T&A export sector in Vietnam, including the importance of different end markets and preferential market access, types of firms and upgrading processes in the sector. In the following, regulatory changes of the EVFTA specific for the T&A sector are discussed followed by an overview of potential impacts on Vietnam's T&A sector discussing opportunities and challenges of the FTA. The last section concludes and provides some policy recommendations.

#### 4.3.1. The global textile and apparel sector<sup>11</sup>

The T&A sector has traditionally been a gateway to export diversification for particularly LDCs and is generally regarded as a first step for developing countries embarking on an export-oriented industrialization process. Given its low entry barriers (low fixed costs and relatively simple technology) and its labor intensive nature, particularly the apparel sector provided employment opportunities particularly for previously marginalized groups of workers, such as women and unskilled workers, who often did not have access to wage employment beforehand as well as upgrading opportunities into higher value-added activities within and across sectors (Staritz 2012). However, the defining characteristics of the apparel industry also mean that it is very competitive. It is easy to enter and relatively foot-loose as production and trade patterns can be adjusted quickly to changing market conditions. This can be also seen in the existence of often very problematic working conditions

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<sup>11</sup> This section partly draws on the description of the global T&A sector of the EPA study of this project (Grumiller et al., 2018).

as has been most dramatically shown in recent fires and building collapses in major South Asian apparel supplier countries. Besides occupational health and safety (OHS) issues, most pressing issues in the global apparel sector are low wages, excessive overtime, high work intensity and flexible working arrangements that are related to cost pressures and the often short lead times and flexible orders of global buyers. Further, the rights to organize and to collective bargaining are often scrutinized (see Plank et al. 2014).

The T&A sector is a prime example of a sector being organized in organizationally and geographically fragmented global value chains (GVCs) where production of components and assembly into final products is carried out via inter-firm networks on a global scale. The apparel sector can be roughly divided into four stages that are intertwined with the textile sector: (i) raw material supply, including natural (e.g. cotton and wool) and synthetic or man-made fibers (e.g. polyester, nylon and acrylic); (ii) yarn and fabric production and finishing (textile sector); (iii) apparel production; and (iv) distribution and sales channels at the wholesale and retail levels. Natural and synthetic fibers are produced from raw materials such as cotton, wool, silk, flax and chemicals. These fibers are spun into yarn which is used to produce woven or knitted greige fabric. The fabrics are then finished, dyed or printed and cut into pieces to produce apparel, home furnishings and industrial and technical textile products for a variety of end-use markets. In contrast to the labor-intensive apparel sector, textile (yarn and fabric) production is more capital and scale intensive and relies more heavily on technology and skills which explains why textile production has partly remained in developed countries or shifted towards middle-income countries whereas apparel production has been also relocated to LDCs (Staritz 2012).

T&A represents a classic example of a buyer-driven value chain which are characterized by decentralized, globally dispersed production networks, coordinated by lead firms who control activities that add “value” to products (e.g., design, branding), but often outsource all or most of the manufacturing process to a global network of suppliers (Gereffi 1999). Although buyers are not directly involved in production, they yield significant control over manufacturers and stipulate often detailed product and production specifications. The strategies of lead firms/buyers, in particular their global sourcing policies in terms of costs, quality, lead times and flexibility, as well as compliance, importantly shape production and trade patterns and upgrading opportunities in the T&A sector. Major criteria in sourcing policies include: (i) time criteria such as rapidly declining lead times of several weeks (in contrast to the earlier several months) and increasing flexibility which requires differently organized production processes, (ii) requirement of non-manufacturing capabilities (outside apparel assembly) such as input sourcing, product development, inventory management and stock holding, logistics and financing, and (iii) compliance with safety, labor and environmental standards which has become a minimum criterion for entering and remaining in many global value chains.

In countries where the T&A sector is dominated by FDI which is common particularly in LDCs, additionally the investment strategies of foreign investors are important. These have important implications on the role of foreign-owned plants in GVCs and potentials for upgrading. Most importantly, transnational investors which are part of global production arrangements with headquarters mostly in advanced Asian countries such as Korea and Taiwan and more recently also China have minimal decision making power and linkages in host countries as they have a clear global division of labor with plants in less developed production locations often being only involved in low value added activities. This is in contrast to more embedded investors that have more interest to expand activities, value added and linkages in host countries (Morris et al. 2016).

At the supplier side, apparel manufacturing is highly competitive and becoming more consolidated. Developing countries are in constant competition for FDI and contracts with lead firms/buyers, leaving many suppliers with little leverage in the chain. Given this intense competition and the commodity nature of manufacturing activities, strategies of upgrading are extremely important for suppliers to remain and improve their positions in apparel GVCs. Supplier countries and firms can pursue several strategies to upgrade. Five are identified in the literature (Kaplinsky/Morris 2001; Humphrey/Schmitz 2002; Frederick/Staritz 2012a):

- Process upgrading: Improving technology and/or production systems to gain efficiency and flexibility
- Product upgrading: Shifting to more sophisticated and complex products
- Functional upgrading: Increasing the range of functions or changing the mix of activities to higher-value tasks, for example moving beyond production-related activities such as design, input sourcing or distribution/logistics
- Supply chain upgrading: Establishing backward manufacturing linkages within the supply chain, in particular to the textile sector but also to accessories
- End market upgrading: Diversifying to new buyers or new geographic or product markets

Functional upgrading is of specific importance and also represents the main categories of apparel suppliers. An assembly or cut-make-trim (CMT) manufacturer is responsible for sewing apparel and may be responsible for cutting the fabric and providing simple trim (buttons, zippers, etc.). The buyer provides product specifications and the fabric. The apparel factory is paid a processing fee rather than a price for the product. A full package or original equipment manufacturer (OEM) purchases (or produces) the textile inputs and provides all production services, finishing, and packaging for delivery to the retail outlet. The customer provides the design and often specifies textile suppliers. An original design manufacturer (ODM) is involved in the design and product development process, including the approval of samples and the selection, purchase and production of required materials. The last upgrading step in this trajectory is original brand manufacturing (OBM) where suppliers develop their own brands and are thus also in charge of branding and marketing (Gereffi 1999).

Besides the crucial importance of organizational dynamics, in particular strategies of lead firms/buyers and foreign investors, regulatory factors decisively influence global production and trade patterns in T&A GVCs. The T&A industry has been one of the most trade-regulated manufacturing activities in the global economy having been governed by a system of quotas until 2004 (the Multi-Fibre Arrangement (MFA) and later the Agreement on Textile and Clothing (ATC)) and remaining high tariff rates. Average Most Favored Nation (MFN) tariffs on apparel imports are around 10.5% for the EU and the US with considerable variations for product categories, in particular in the US where tariffs vary between 0 and 32% (WTO 2016). In this context preferential market access has a substantial impact on global T&A trade patterns, including bilateral and regional trade agreements as well as the Generalized System of Preferences (GSP) within which the EU has offered more favorable preferential access for LDCs, such as with the Everything but Arms (EBA) and the GSP+ initiatives (Frederick/Staritz 2012a). Hence, the EVFTA plays a crucial role as it changes preferential market access conditions for Vietnam.



### 4.3.2. Overview of Vietnam's T&A sector<sup>12</sup>

The T&A sector is of central importance to Vietnam's economy. In 2015, 12% of Vietnam's exports accounted for apparel which makes the sector the second largest export sector in the country (after electronics). The EU is the second largest end market accounting for 14% of total apparel exports behind the US with 48% and followed by Japan and Korea with 12% and 10% respectively (UN Comtrade 2017). For the EU, Vietnam is the sixth largest apparel exporter after China, Bangladesh, Turkey, India and Morocco (see also Table 13). The T&A sector is the largest formal employer in Vietnam, providing jobs for 2.5 million people with a female share of 80%. The share of the apparel sector in manufacturing employment increased from 16% in 2005 to 21% in 2014 (GoV 2016).

#### Development of the apparel sector

The French laid the foundations for the T&A sector in Vietnam in the late 19th century with the establishment of the Nam Dinh textile complex in the Red River Delta in Northern Vietnam. However, the sector only started to develop at a larger scale after the end of the First and Second Indochina wars (1946-75) and in the context of the Council for Mutual Economic Assistance (CMEA). During the 1980s the sector evolved based on the cooperation program between Vietnam and the Soviet Union and Eastern European countries. Vietnam's role in this context was to assemble apparel products and some textiles such as embroidered products for exporting to the Soviet Union and Eastern European countries. All machines and inputs were supplied by foreign partners and Vietnamese firms received an assembling fee for their production (CMT). This cooperation program did however not last long due to the collapse of CMEA in the late 1980s with negative repercussions on Vietnam's apparel sector (Huy et al. 2001). Despite growing apparel production and exports in the 1980s, the scale of the apparel sector was relatively modest during the state socialist period and the major phase of export-oriented development in the apparel sector started only in the early 1990s.

In the context of the 'doi-moi' reforms in the late 1980s, the apparel sector (together with other labor-intensive manufacturing sectors such as footwear and electronics) played a key role in Vietnam's export-led development strategy. Export growth was based on SOEs and on rising foreign investments. Many of the vertically integrated textile and apparel SOEs modernized their equipment in the 1990s drawing on preferential access to finance. Foreign investors, in particular from Japan, Korea and Taiwan, invested in the apparel sector in the 1990s motivated by access to low-cost labor. In terms of end markets, Vietnam's main export markets differed substantially from other developing countries in the 1990s. Due to Vietnam's specific situation related to the Second Indochina war and the related US embargo (until 1994), its CMEA past and socialist system, and non-WTO membership (until 2007), Vietnam faced market access restrictions in the main markets of the EU and in particular the US. Thus, after the collapse of CMEA, the first alternative available for exporters was the Japanese market that dominated apparel exports in the 1990s. Since the early 2000s, however, the development in the Japanese market has been modest compared to the EU and the US.

From 1992 onwards exports to the EU increased importantly due to the bilateral agreement concluded in 1992 and taking effect in January 1993 that secured improved market access for Vietnamese apparel exports in the EU. This agreement was widely perceived as an initial spark for the development of the apparel sector (Huy et al. 2001; Nadvi et al. 2004b).

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<sup>12</sup> This section is partly based on Staritz/Frederick 2012b.

According to the agreement, Vietnam was entitled to export to the EU market 151 categories, of which 46 were not subject to quota. The agreement was later followed by a broader cooperation agreement in which the EU granted MFN-status to Vietnam in 1995. Later Vietnam also enjoyed preferential access under the EU's GSP system. In the context of a bilateral Market Access Agreement also quantitative restrictions on apparel exports were lifted in March 2005 which put Vietnam on a par with WTO members roughly two years ahead of Vietnam's WTO entry in 2007. Thus, EU imports from Vietnam are subject to average tariffs of around 9%, which, while better than the around 11% MFN average tariff, is less advantageous than the tariff free access for LDCs such as Bangladesh and Cambodia.

Until the early 2000s Vietnam was by and large excluded from the US market which had played an important initial role in many other late industrializing countries. Although the US terminated its embargo on exports from Vietnam in 1994 trade relations remained initially low (Martin 2010). However, with the signing of a bilateral trade agreement in 2001, the US granted Vietnam normal trading relations (MFN status). For apparel exports the agreement reduced the average tariff rate from around 60% to MFN tariffs averaging at 11.5% and unlike the EU preferential trade agreement no quotas were initially foreseen. However, after significant export growth in 2002, the US industry lobbied for quotas and thus a bilateral quota agreement for selected apparel products was signed. The agreement placed quantity quotas on 38 categories of apparel imports from Vietnam from 2003 onwards until Vietnam's WTO accession in 2007.

Apparel exports have increased significantly since the early 1990s. Import data from Vietnam's trading partners shows an increase from USD 831 million in 1995 to USD 23,862 million in 2015 (Table 10). The share of Vietnam in global apparel exports increased from 0.5% in 1995 to 7.4% in 2015. Woven exports were higher than knit exports but declined in importance accounting for 77% in 1995 and only 52% in 2015. With regard to end markets, today, Vietnam's major apparel markets are concentrated within the US (48%), the EU (14%) and Japan (12%) accounting together for 74% in 2015 (Table 11). The composition of final markets has changed significantly. In the 1990s Japan and the EU were the only important end markets. In the early 2000s Japan's share decreased – also the EU's share but to a lesser extent – and the US emerged as the number one export market. Three other, albeit less significant, end markets are Korea, China and Canada. See Figure 10 for the development of apparel exports to main end markets.

This strong focus particularly on the US market with 48% of total exports is problematic. It is related to different buyer requirements in these end markets and particularly most US buyers demanding higher volumes whereas EU buyers demand smaller quantities and often shorter lead times and more involvement in FOB and also ODM. For example, based on interviews with apparel firms in Vietnam, a typical large US buyer demands hundred thousand pieces per style while an EU buyer may demand less than 10.000 pieces. In the EU market competition is also stronger as all LDCs have duty free market access through EBA while in the US only regional suppliers and SSA countries (through AGOA) have duty free market access. Hence, important competitors such as Bangladesh and Cambodia can export duty free to the EU but not to the US. It has been difficult for Vietnam to compete with these countries in the EU market on simple low quality products given the duty disadvantage up to now.



Table 10: Vietnam's apparel exports to the world

|  | 1995 | 2000  | 2005  | 2010   | 2011   | 2012   | 2013   | 2014   | 2015   |
|--|------|-------|-------|--------|--------|--------|--------|--------|--------|
| <b>Value (million USD)</b>                 | 831  | 1,595 | 4,692 | 10,590 | 13,498 | 14,601 | 17,669 | 20,716 | 22,750 |
| <b>Share of global exports</b>             | 0.5% | 1.0%  | 2.2%  | 4.0%   | 4.4%   | 5.0%   | 5.8%   | 6.5%   | 7.4%   |
| <i>Woven and Knit Values (million USD)</i> |      |       |       |        |        |        |        |        |        |
| <b>Woven</b>                               | 641  | 1,265 | 3,009 | 5,585  | 7,467  | 7,983  | 9,408  | 11,177 | 11,892 |
| <b>Knit</b>                                | 190  | 330   | 1,683 | 5,006  | 6,032  | 6,618  | 8,262  | 9,539  | 10,858 |
| <i>Woven and Knit Share (%)</i>            |      |       |       |        |        |        |        |        |        |
| <b>Woven Share</b>                         | 77.2 | 79.3  | 64.1  | 52.7   | 55.3   | 54.7   | 53.2   | 54.0   | 52.3   |
| <b>Knit Share</b>                          | 22.8 | 20.7  | 35.9  | 47.3   | 44.7   | 45.3   | 46.8   | 46.0   | 47.7   |

Notes: Exports represent world imports from Vietnam; Apparel represented by HS1992: Woven: HS62; Knit: HS61; Data retrieved 15/05/2017.

Source: UN Comtrade 2017

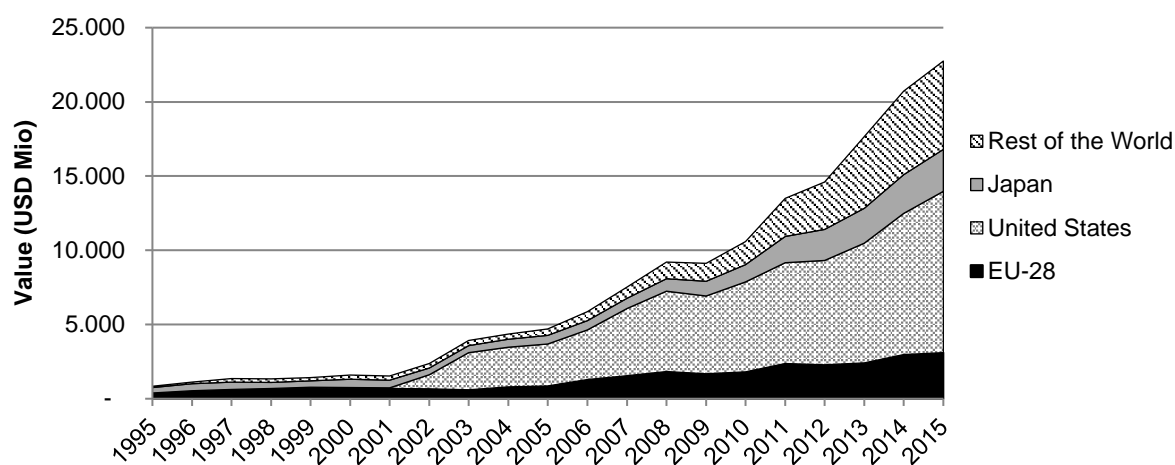
Table 11: Vietnam's Top Five Apparel Export Markets by Year

| Country/ Region      | Value (million USD) |              |              |               |               | Market Share (%) |      |      |      |      |
|----------------------|---------------------|--------------|--------------|---------------|---------------|------------------|------|------|------|------|
|                      | 1995                | 2000         | 2005         | 2010          | 2015          | 1995             | 2000 | 2005 | 2010 | 2015 |
| <b>World</b>         | <b>831</b>          | <b>1,594</b> | <b>4,688</b> | <b>10,573</b> | <b>22,750</b> |                  |      |      |      |      |
| <b>United States</b> | 18                  | 53           | 2,832        | 6,073         | 10,861        | 2.2              | 3.3  | 60.4 | 57.4 | 47.7 |
| <b>EU-28</b>         | 368                 | 693          | 859          | 1,806         | 3,111         | 44.3             | 43.5 | 18.3 | 17.1 | 13.7 |
| <b>Japan</b>         | 366                 | 580          | 587          | 1,164         | 2,826         | 44.1             | 36.4 | 12.5 | 11.0 | 12.4 |
| <b>Korea, Rep.</b>   | 22                  | 35           | 41           | 376           | 2,213         | 2.6              | 2.2  | 0.9  | 3.6  | 9.7  |
| <b>China</b>         | —                   | 2            | 9            | 75            | 727           | —                | 0    | 0    | 0.7  | 3.2  |
| <b>Canada</b>        | 21                  | 23           | 87           | 264           | 662           | 2                | 1    | 1.8  | 2.5  | 2.9  |
| <b>Oth.Asia, nes</b> | —                   | 90           | 92           | 134           | 244           | —                | 5.6  | 2.0  | 1.3  | 1.1  |
| <b>Top 5</b>         | 794                 | 1,562        | 4,456        | 9,682         | 19,739        | 93.2             | 85.5 | 92.3 | 89.8 | 86.8 |

Notes: Apparel represented by HS1992 (61+62); Exports represented by partner country imports; (—): indicates country not in top 5 in given year. Data retrieved 15/05/2017.

Source: UN Comtrade 2017

Figure 10: Vietnam's apparel exports to the EU-28, the US and Japan



Notes: Exports represented by imports reported by partner countries; Values in USD millions. Data retrieved 15/05/2017

Source: UN Comtrade 2017

Vietnam's positive apparel export development since the 1990s can be explained by market access particularly to Japan, the EU and the US becoming more favourable in the 1990s and 2000s which culminated in Vietnam's WTO entry in 2007. Currently, Vietnam faces preferential market access to Japan where it has enjoyed duty-free market access since 2009 in the context of the Japan-Vietnam Economic Partnership Agreement (EPA), to Korea through the Korea- Vietnam FTA, to the Eurasian Economic Union (EAEU), to Chile, and to the EU (see below). In the US market Vietnam's apparel exports face MFN tariffs. This would have been changed through TPP that would have provided duty free access but TPP is currently on hold. Vietnam is also a member of regional trade arrangements, most importantly ASEAN that it joined in 1995. As a member of ASEAN Vietnam is part of the ASEAN-China Free Trade Agreement (ACFTA) and the ASEAN agreement with Japan, Korea, India, and Australia and New Zealand.

Other important factors in Vietnam's export development are Vietnam's low labor costs combined with relatively high operator skills leading to comparatively high productivity and the possibility to produce high quality and complicated style products as well as some important restructuring and upgrading processes which were also supported by targeted government policies. In addition, Vietnam's location is advantageous given its strategic position in the region and its proximity to China as the main textile and accessories input provider. Challenges remain, however; most importantly the focus on apparel assembly (CMT), the large share of imported textiles related to the underdevelopment of the local textile sector and other supporting industries including accessories, concentration on relatively simple low value products, and a skill gap in particular with regard to technological, design/fashion, management and marketing skills. In the following an overview of the ownership of firms in the apparel sector and important upgrading processes with a focus on functions performed and types of export products is given, concluded by a discussion of government T&A sector specific policies.

### **Ownership of firms**

According to the Vietnam Textile and Apparel Association (VITAS), there are up to 6,000 firms in the T&A sector in 2016; the majority of them are small and medium sized. More than 4,000 of these firms are locally owned with a bit less than 2,000 FDI firms. FDI firms focus on exporting and also 60-70% of the local firms are exporting. In terms of ownership, there are three types of firms in Vietnam – SOEs, locally owned private firms, and foreign owned firms.

With regard to apparel output, SOE's share has declined quite importantly since the 1990s while foreign firms increased their share. In the textile sector the role of foreign firms also increased, albeit not as strongly as in apparel. Since the advent of the 'doi-moi' reforms Vietnam has modernized and reformed part of its SOEs. SOEs tend to be large in size often employing several thousands of workers and have several advantages over private firms due to their direct access to the state system, including preferred status in access to funds (Huy et al. 2001; Nadvi et al. 2004b). The locally owned private firms are usually small- or medium-sized owner-managed firms. The process of equitisation has however reduced the number of SOEs and increased the private ownership share in firms where the state remained a share. Today, there is only a small share of firms that is purely state-owned. Most SOEs have been equitized to private investors but the state often still owns a share, particularly at larger firms. Hence, SOEs (including firms partly owned by the

state) still have a central role. Vinatex<sup>13</sup> – the largest SOE in the T&A sector – has also been equitized but the state owns an important share in the mother company and some members are still 100% state owned.

Foreign firms have increased since the late 1990s. In particular investors from East Asia, including Taiwan, Korea and to a lesser extent Japan and later on China, have entered joint ventures with SOEs and later increasingly set up 100%-owned subsidiaries which are focused almost exclusively on exports. Today, there are nearly 2,000 FDI firms in the T&A sector according to VITAS. Main FDI host countries today are Korea, Taiwan and Hong Kong through which also Chinese FDI is channelled. Japan, US and EU FDI is rather small in the T&A sector and Thai investment has just increased in the context of ASEAN. Foreign firms are generally larger. Representatives of the industry association estimate that 65% of total apparel exports come from FDI firms.

### **Functions performed**

Regarding functions performed by apparel firms, based on interviews with the industry association VITAS and sector experts, more than 70% of firms are engaged in CMT and around 25% in FOB and 5% in ODM. For CMT only the price is important and Vietnam can compete on prices. For FOB prices paid by buyers are higher but supplier firms have to take over more functions and risks in which most firms have no experience and are therefore less competitive. For smaller local firms a problem is that they have no established relationships with textile suppliers and as they only need small quantities of textiles textile providers do not give them priority. Also organizing transport and logistics is challenging for smaller firms with to separate logistics departments. It would be easier for local apparel exporters if suitable textiles inputs were available locally. But currently the majority of imports needs to be imported. With regard to the domestic market, there is a substantive number of Vietnamese firms that produce for the domestic market in addition to exporting. In the domestic markets firms also have own brands and are hence engaged in OBM. Also some large SOEs produce for the domestic market and additionally also have their own retail outlets. The domestic market is however competitive because of Chinese and Thai imports, including illegal ones.

The three types of apparel firms discussed above fulfill generally different functions in GVC. Local private firms tend to be concentrated in CMT positions focusing on apparel assembly. However, some locally owned private firms also invested in the textiles sector, in particular in yarn spinning to be exported to Korea, Japan, Malaysia and Turkey. The larger SOEs have more functional responsibilities as mostly FOB producers. SOEs are generally in charge of input sourcing, also through their vertically-integrated production units as an important share of SOEs is vertically integrated – from spinning to weaving/knitting to apparel assembly. Foreign-owned subsidiaries generally use more modern production processes and machinery which leads to high productivity. But as they tend to cater to the needs of their headquarters functions performed in Vietnam are often limited with limited room for functional upgrading of these plants as higher-value functions remain with the overseas headquarters. This includes input sourcing, product development, design and logistics. However, there are differences with some FDI firms being more embedded in Vietnam. Textile investments by FDI firms have also increased which can be seen by Korean and Taiwanese investments in cotton and synthetic fabrics.

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<sup>13</sup> Vinatex was established in 1995 as a holding company for SOEs and comprised 90 companies. 66 of these companies were actual manufacturers while the remainder included research institutes, educational and training facilities, commercial offices, spares suppliers and distributors. Vinatex is involved in woven and knitted apparel (40% of total production) and textile (60%) production. Today the number of members is smaller accounting for around 40 companies.

Hence, in addition to CMT production there has been upgrading to FOB and even some initiatives with regard to OEM and OBM production, but this is still the minority and CMT production remains important in Vietnam's apparel sector. The same can be said for backward linkages into textile; they have increased but Vietnam's boom in apparel exports has relied to an important extent on imported textiles. As buyers prefer FOB and as costs will increase in Vietnam which will require taking over more functions than sewing to remain competitive, upgrading to FOB production will be required. A competitive local textile sector would make FOB production easier particularly for the large share of smaller local firms. Additionally, local textile sourcing would allow fulfilling RoO requirements of recent FTAs and increase local value added and linkages (see below).

### **Export products**

Vietnam's apparel exports are almost equally divided between woven and knit apparel items with 53% and 47% shares respectively in 2015. Until 2000 woven items dominated exports accounting for around 75 to 80% of total exports. Vietnam's apparel exports, woven and knit, are concentrated in a few products; however, the concentration has decreased and is lower than in competitor countries such as Cambodia and Bangladesh. In the EU, the top 5 product categories account for 30% of total EU apparel exports in 2015 and the top 10 product categories for 46% (Table 12). Compared to the US, the top export product categories overlap but in the US woven and knit products are equally important while in the EU market woven products dominate accounting all of the top 5 products and for 8 out of the top 10 products. In the EU market the top 10 products include cotton- as well as men-made fiber- and synthetic-based product while in the US cotton-based products dominate. The most important products in both markets are trousers, sweaters/sweat-shirts and shirts. Jackets are of greater importance in the EU-15 market while t-shirts have greater significance in the US market. Products such as jackets and blouses are generally more complicated than simple trousers, sweaters and shirts, but there can be variation among product group. Comparing the unit values of the top 10 exports products from Vietnam to the average unit values of EU imports for these products shows that for 7 products Vietnamese unit values are below the average – albeit not much – and for one it is nearly the same and only for 2 products they are above, including men's jackets (top 2) and men's garments (top 7). This confirms the general concentration in rather low-value added export products despite improvements with regard to product diversification (Table 12).

### **Government policies**

Given Vietnam's socialist political system, the government has had a large role in the development of the T&A sector, together with the state-dominated industry association and trade union. The government established export processing zones (EPZs) and duty drawback regulations to allow for the duty-free import of inputs based on the condition that they are re-exported as apparel products within 90-120 days. In the late 1990s, the government initiated a strategy for the development of the T&A sector – the 'Speed-up Development Strategy for 2010'. A key aim was to further vertical integration of the apparel sector, in particular by restructuring the domestic textile industry to improve the quality and availability of local textiles. The second important aim was to promote a shift from the dominant CMT role of Vietnamese suppliers towards FOB and later ODM and OBM (Nadvi et al. 2004a; Goto 2007). To combat weaker global demand in the context of the global economic crisis, the government initiated several policies in the late 2000s including an export credit insurance project, a bank loan subsidy program for SMEs to improve working capital

provision, awareness raising efforts to ‘buy Vietnamese’ in the local market and an exemption from a recent minimum wage rise (ILO 2009). The industry’s strategy in 2010 reflects its attention to buyer relations, functional upgrading, vertical integration and social and environmental compliance. The following points are seen as central (AFTEX 2010): (i) Re-structure production by moving textile out of cities and into industrial parks with wastewater treatment plants to protect the environment and moving apparel to rural areas where labor is readily available and less expensive. (ii) Encourage large firms to establish and maintain long-term relationships with overseas importers and retailers. (iii) Add value to products by improving the finishing segment and using fashion techniques (design, services, and branding) to increase customer, and thus retailer, loyalty. (iv) Pay proper attention to local markets regarding appropriate products, prices and distribution channels. (v) Improve the quality of life of workers through training to increase job loyalty and minimize labor disputes. (vi) Increasing vertical integration in the apparel and textiles sector to reduce imported materials.

Table 12: Top 10 EU Apparel Imports from Vietnam (2015)

| HS Code       | Products                               | Value<br>(in million EUR) | Share<br>(in %) | Unit values<br>(EUR/kg) | Avg UV<br>(EUR/kg)* |
|---------------|--|---------------------------|-----------------|-------------------------|---------------------|
| <b>Total</b>  |  | <b>2,805</b>              |                 |                         |                     |
| 620293        | Women’s Jackets, not knitted           | 189                       | 6.7             | 24.6                    | 26.2                |
| 620193        | Men’s Jackets, not knitted             | 185                       | 6.6             | 28.4                    | 26.8                |
| 620343        | Men’s Trousers, excl. knitted          | 168                       | 6.0             | 20.5                    | 21.3                |
| 620520        | Men’s Shirts, excl. knitted            | 164                       | 5.8             | 28.3                    | 29.4                |
| 620463        | Women’s Trousers, excl. knitted        | 136                       | 4.9             | 18.0                    | 24.8                |
| 611030        | Jerseys, Pullovers, knitted            | 100                       | 3.6             | 18.6                    | 19.4                |
| 621040        | Men’s Garments, impregnated,           | 96                        | 3.4             | 33.4                    | 27.6                |
| 620342        | Men’s Trousers, excl. knitted          | 94                        | 3.3             | 19.8                    | 19.7                |
| 610990        | T-Shirts, knitted, excl. cotton        | 89                        | 3.2             | 23.9                    | 25.7                |
| 620640        | Women’s Blouses, Shirts, excl. knitted | 79                        | 2.8             | 20.4                    | 32.5                |
| <b>Top 10</b> |  | <b>1,300</b>              | <b>46.3</b>     |                         |                     |

Notes: \* These are the average unit values of EU imports from the world of the top 10 export products of Vietnam.  
Source: Eurostat 2017

### 4.3.3. Regulatory changes through the EVFTA

#### Tariffs on export side

All interviewed actors agree, that market access through tariff reduction is the most important advantage of the EVFTA for Vietnam. Tariffs on T&A products are comparatively high under the existing trade regimes between Vietnam and the EU, particularly if compared to main competitor countries such as Bangladesh and Cambodia that have faced duty free market access given their LDC status. For the other top EU exporters ranking above Vietnam, Turkey also has duty free access due to its Customs Union and Morocco due to an FTA with the EU whereas India has GSP tariffs and China MFN tariffs for apparel exports. For Vietnamese exports, GSP tariffs apply for T&A exports to the EU that account on average for around 9%. There are only small differences between average tariffs on

knitted apparel (9.4%), woven apparel (9%) and made up textiles (8.1%). Table 13 shows the tariffs applied in different EU trade regimes for the top 10 apparel exporters to the EU. Eliminating tariffs will hence importantly increase the competitiveness of Vietnamese apparel exports in the EU market; however, Vietnamese apparel exporters do not expect that they will receive the gains as they will go to buyers. Hence, prices earned in Vietnam are not expected to increase as prices that buyers are prepared to pay are expected to be adjusted in accordance with the tariff reduction. The advantage is hence increased competitiveness of Vietnam in the eyes of apparel buyers, but no higher prices for Vietnamese exporters.

*Table 13: Tariff regimes of top 10 apparel exporters to the EU*

| Exporters to EU-28* | Tariff Regime** | Tariffs                    |                                |                                      |
|---------------------|-----------------|----------------------------|--------------------------------|--------------------------------------|
|                     |                 | HS 61 Knitted or crocheted | HS 62 Not knitted or crocheted | HS 63 Other made up textile articles |
| <b>China</b>        | MFN             | 11.7                       | 11.3                           | 10.1                                 |
| <b>Bangladesh</b>   | EBA             | 0                          | 0                              | 0                                    |
| <b>Turkey</b>       | Customs Union   | 0                          | 0                              | 0                                    |
| <b>India</b>        | GSP             | 9.4                        | 9.0                            | 8.1                                  |
| <b>Morocco</b>      | FTA             | 0                          | 0                              | 0                                    |
| <b>Vietnam***</b>   | GSP             | 9.4                        | 9.0                            | 8.1                                  |
| <b>Cambodia</b>     | EBA             | 0                          | 0                              | 0                                    |
| <b>Tunisia</b>      | FTA             | 0                          | 0                              | 0                                    |
| <b>Pakistan</b>     | GSP+            | 0                          | 0                              | 0                                    |
| <b>Sri Lanka</b>    | GSP+            | 0                          | 0                              | 0                                    |

Notes: \* Ranked by average export value to EU-28 for period 2011 to 2016; \*\*Simple average; \*\*\* Before coming into force of EVFTA.

Source: Eurostat 2017, TRAINS.

Tariff reductions on EU imports of Vietnamese apparel will be implemented within 7 years after ratification of the FTA. Table 14 shows the specific liberalization schedule for EU tariffs on apparel imports from Vietnam. The majority of imports will be liberalized in six (B5) and eight (B7) annual steps after coming into force of the EVFTA. This includes in particular woven products (HS 62) with 67% of total apparel imports and another 15% in form of knitted products (HS 61). Hence, only 10% of total EU apparel imports will be liberalized with the entry of the agreement, and another 8% in 4 annual steps after the entry of the agreement. This slow pace of liberalization is criticized by Vietnamese apparel sector actors as they will only have fully liberalized access to the EU in up to 7 years.



Table 14: EU tariff reduction schedule for apparel imports from Vietnam

| HS Code<br>Product                              | GSP  | EVFTA Tariff Reduction |                        | EU – Imports            |                                |
|---|------|------------------------|------------------------|-------------------------|--------------------------------|
|   |      | Schedule               | Value<br>(million USD) | Share<br>(per HS group) | Share in Apparel<br>(HS 61+62) |
| <b>HS 61 Knitted or<br/>crocheted</b>           | 9.4% | A                      | 188                    | 25.0%                   | 6.7%                           |
|   |      | B3                     | 136                    | 18.1%                   | 4.8%                           |
|   |      | B5                     | 430                    | 57.0%                   | 15.2%                          |
| <b>HS 62 Not knitted or<br/>crocheted</b>       | 9.0% | A                      | 94                     | 4.6%                    | 3.3%                           |
|   |      | B3                     | 80                     | 3.9%                    | 2.8%                           |
|   |      | B5                     | 1,295                  | 62.6%                   | 45.9%                          |
|   |      | B7                     | 597                    | 28.9%                   | 21.2%                          |
| <b>Total Apparel</b>                            |      |                        | 2,822                  |                         |                                |
| <b>HS 63 Other made up<br/>textile articles</b> | 8.1% | A                      | 189                    | 91.7%                   |                                |
|   |      | B3                     | 4                      | 1.7%                    |                                |
|   |      | B5                     | 14                     | 6.6%                    |                                |

Notes: Tariff Reduction classified in different schedules: A=tariff reduction to 0 with the entry of the agreement (t), B3=tariff reduction to 0 in 4 annual steps (t+3); B5=tariff reduction to 0 in 6 annual steps (t+5), B7=tariff reduction to 0 in 8 annual steps (t+7).

Source: EVFTA, UN Comtrade, TRAINS

## Rules of origin

RoO regulations are crucial as they determine if T&A products can make use of preferential market access. For apparel, RoO are commonly differentiated in single transformation where only the sewing stage has to take place in the beneficiary country (fabric to apparel), double transformation (also called fabric forward rule) where also one input production step has to be conducted such as knitting or weaving of fabric (yarn to fabric), and triple transformation (also called yarn forward rule) where in addition to knitting/weaving also the spinning of yarn has to take place in the beneficiary country (fiber to yarn). The specification of these manufacturing processes has a large impact on possible sourcing practices and competitiveness, since they define whether firms can source intermediate inputs from abroad and continue to qualify for preferential access to the EU market.

Since textile production is more capital and scale intensive than apparel production, double and triple transformation acts as a significant market barrier for countries or regions without a competitive textile sector. Furthermore, even in the case of a developed textile sector, exporting firms might still need to source additional fabric and yarn from abroad. This is often a requirement to be part of certain GVCs as lead firms/buyers stipulate textile mills on a global basis that have to be used by their apparel suppliers. Hence, even though the motivation behind more restrictive RoO might be to support backward integration, double and triple transformation RoO may hinder market access in GVCs given the capital and scale intensive nature of textile production that makes establishing competitive textile sectors challenging. However, importing textile from abroad has also disadvantages in terms of lead times, flexibility and costs. Hence, developing competitive local or at least regional textiles sectors that can be used for the production of apparel exports will be crucial for



competitiveness and value added reasons but imports will still be required as not all types of textile products can be produced locally.

The RoO in the EVFTA are restrictive as they require double transformation which means fabric forward for apparel products. Hence, fabric has to be sourced locally to enjoy preferential market access in the EU. In the case of fabric exports, yarn has to be sourced locally (fibre to fabric).<sup>14</sup> RoO are the same as for the GSP but given the larger tariff exemptions that can be accessed through the EVFTA RoO, they become much more important for Vietnamese exporters within the EVFTA. Cumulation possibilities exist with Korea given the existing FTA between the EU and Korea but not with ASEAN member countries. This is different to the Japan FTA as given the agreement of Japan is with ASEAN cumulation is allowed with ASEAN member countries. In the case of TPP, cumulation would have been allowed with all TPP member countries but also not generally with ASEAN. This can be a crucial challenge for firms and the sector more generally in accessing the benefits of the EVFTA. Restrictive RoO can however also spur the development of backward linkages and a competitive local textile sector which will be important for the long term competitiveness of the apparel sector in Vietnam and also for increased local value added and linkages and hence the broader development process of the country. A drawback is however that it will take up to 7 years for tariffs to be liberalized in the context of the EVFTA. This long time horizon for complete tariff elimination reduces the incentive to develop the local textile sector. This is particularly important given ideas that the EVFTA might be expanded to an EU-ASEAN FTA, which would mean that important textile suppliers enter the FTA offering cumulation opportunities.

In the case of TPP that required triple transformation (yarn forward rule) and where elimination schedules were also longer term, the agreement spurred investments into textile production. For the EVFTA this is seen less strongly but firms that invested in textile production motivated by TPP aim to use these capacities now for the EVFTA. Foreign textile firms interviewed at a textile expo in HCMC in April 2017 confirmed this development. For most firms the main motivation to invest in textiles production was TPP and with the end of TPP they stopped their investments. The end of TPP was disappointing particularly for the newly arrived investors. But now that TPP is gone most textile firms tend to remain and will shift to the EU and the EVFTA. Some textile firms also try to sell to other countries with an FTA with the EU that demand double transformation. Hence, there is no large disinvestment expected and the textile sector is expected to continue to grow despite the end of the TPP but at a much slower pace. The most important foreign textile investors are from Taiwan and Korea. Taiwan has invested quite strongly since the TPP negotiations. Most are vertically integrated firms that use a large share of their own textile production in their apparel exports. Korean investments in textiles have also increased in the context of TPP negotiations. But, regarding the EVFTA, Korean apparel firms aim to use cumulation and hence to increase textile exports from Korea to Vietnam and not investments in textiles. Data on new FDI projects in 2014 and the first half of 2015 confirm an increase of FDI not only in apparel production but also in fabric and dyeing, yarn and accessories production (VITAS 2016).

These developments in the textile sector are confirmed by textile production and establishment data and machinery import data. In 2014 Vietnam produced 182,000 tons of filament yarn, 900,000 tons of spun yarn, 1,500 million square metres of woven and knit fabric and 1,500 million square meters of printing and finishing. Disaggregated data for 2014

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<sup>14</sup> Printed fabrics benefit from the so called 'printing rule' like in GSP, which means that printing accompanied by at least two preparatory or finishing operations may confer originating status provided that the value of the unprinted fabric used does not exceed a threshold of the ex-works price of the product.

shows that there were 103 units involved in spinning, 388 units in weaving, 100 units in knitting, an additional 9 units in non-woven, and 177 units in dyeing and finishing. This is compared to 4.424 units involved in apparel production (VITAS 2016).

However despite these important developments at FDI firms and the already longer existence of a modernized textile sector concentrated within SOEs, imported textiles still account for an important share of inputs in apparel exports. According to VITAS, 70% of raw materials for apparel exports are imported showing that the textiles and supporting industries are still weak. There are however important differences between woven and knit products with knitted exports using a substantially higher share of local fabric (around 60%) than woven exports (10%). This is because the spinning and knitting sector is better developed with the main bottlenecks being the weaving and finishing/dyeing segments.<sup>15</sup> This is particularly problematic for EU exports that are concentrated in woven apparel. In all textile segments, there remain however problems with quality, price and lead times. Regarding textile imports, in 2015, 50% of textile imports came from China, 18% from Korea, 15% from Other Asia (which is largely Hong Kong), 6% from Japan, and only 5% from ASEAN (Table 6). Cumulation will be allowed with Korea, which covers currently less than one fifth of textile imports. This share is expected to increase as particularly Korean owned apparel firms but also others plan to shift sourcing to Korea with negative impacts on other textile importer countries, including ASEAN regional suppliers.<sup>16</sup>

The government has encouraged investment in textile with a focus on the bottlenecks weaving and dyeing/finishing. But there was critique by industry actors that support was too slow and that the chance to use the FTAs with the US and the EU to push the textile sector has not been fully used. Particularly weaving and dyeing activities have high requirements also from the environmental side. It was mentioned that the government should have a more pro-active role in providing sites with wastewater treatment and other relevant infrastructure for such investments. Further, textile investments by local firms – despite SOEs – seem to be limited related to lack of capital but also knowledge. In this context, local firms could importantly benefit from increased FDI investments in textiles as they often not only lack capital for textile investments – with the exception of former SOEs – but technology, skills and tacit knowledge to operate textile mills efficiently. This would require however, that FDI firms have linkages or other relations with local firms, which seems to be quite limited. Policy measures particularly investment promotion could incentivise such linkages and learning by focusing on supporting FDI firms that have a long term interest in Vietnam and local decision making power and that are interested in local value addition and linkages. The remaining state's shares in T&A firms could also be used strategically to further textiles investments and linkages with smaller private firms.

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<sup>15</sup> In this context, there is no big difference between fabric forward and yarn forward as the spinning segment is better developed than the fabric segment.

<sup>16</sup> However, there are also limits as Korea is good in certain types of textiles, particularly outwear fabric, and less competitive in others.

Table 15: Vietnam's Top Textile Import Countries

| Country/ Region | Value (million USD) |              |              |              |               | Share (%)   |             |             |             |             |
|-----------------|---------------------|--------------|--------------|--------------|---------------|-------------|-------------|-------------|-------------|-------------|
|                 | 1995                | 2000         | 2005         | 2010         | 2015          | 1995        | 2000        | 2005        | 2010        | 2015        |
| <b>WORLD</b>    | <b>735</b>          | <b>1,379</b> | <b>3,435</b> | <b>7,042</b> | <b>12,825</b> |             |             |             |             |             |
| China           | 53                  | 65           | 804          | 2,633        | 6,362         | 7.2         | 4.7         | 23.4        | 37.4        | 49.6        |
| Korea, Rep.     | 338                 | 368          | 754          | 1,394        | 2,273         | 46.0        | 26.7        | 22.0        | 19.8        | 17.7        |
| Oth.Asia, nes   | 66                  | 484          | 827          | 1,271        | 1,878         | 9.0         | 35.1        | 24.1        | 18.0        | 14.6        |
| Japan           | 98                  | 193          | 312          | 517          | 733           | 13.3        | 14.0        | 9.1         | 7.3         | 5.7         |
| ASEAN           | 120                 | 105          | 225          | 427          | 603           | 16.3        | 7.6         | 6.5         | 6.1         | 4.7         |
| Hong Kong, CN   | 66                  | 87           | 331          | 423          | 344           | 9.0         | 6.3         | 9.6         | 6.0         | 2.7         |
| EU-28           | --                  | 48           | 100          | 157          | 206           | --          | 3.5         | 2.9         | 2.2         | 1.6         |
| India           | --                  | 7            | 12           | 97           | 153           | --          | 0.5         | 0.4         | 1.4         | 1.2         |
| <b>Top 5</b>    | <b>599</b>          | <b>1,238</b> | <b>3,028</b> | <b>6,242</b> | <b>11,847</b> | <b>81.5</b> | <b>89.8</b> | <b>88.2</b> | <b>88.6</b> | <b>92.4</b> |

Notes: Textiles represented by SITC 65 Rev. 3. Imports represented by partner country exports to Vietnam. (--): indicates country not in the top five in given year. Data retrieved on 15/5/2017.

Source: UN Comtrade

## Standards

In addition to RoO, fulfilling standards may limit export potential in the EU. As Vietnam is however already an established EU apparel supplier this challenge seems to be limited and manageable. Nevertheless, increasing standards related to chemicals and safety of products as well as corporate social responsibility (CSR) have posed challenges particularly to smaller exporters and have increased the costs of entering the export market. Also certain standards related to TBT that are already a problem today will become more challenging when inputs are sourced locally. Fulfilling TBT standards is the responsibility of the material supplier and if these suppliers are located abroad, it was not the responsibility for firms in Vietnam. With increasing local sourcing, also to fulfil RoO requirements, local firms will become responsible for TBT requirements.

## Tariffs on import side

The domestic market for T&A is relatively small, estimated at around USD 3 billion with low expenditure on T&A per capita. It is supplied by local producers, legal and, more importantly, illegal imports. Looking at total apparel imports to Vietnam accounting for USD 400 million, China accounts for 62% followed by Korea (10%) (Table 7). According to interviews, illegal importing from China and Thailand is however much larger which is not shown in this data. Only Italy shows up in the list of top apparel exporters to Vietnam accounting for 1.6% of imports. Hence, the EU is only a marginal player in the apparel import market. Regarding textiles the EU also only accounts for 1,6% of total textile imports to Vietnam (see table 6). Import tariffs on EU T&A products in Vietnam account for around 11% which is considerably higher than average tariffs on other manufactured goods with 4.9%. For textiles, tariffs will be liberalized with the entry of the agreement and for apparel 44% of the trade value with the entry of the agreement and the rest after three years (3%), five years (38%) and seven years (15%). Principally, this tariff reduction could lead to a surge in EU T&A imports but it is expected that this will only take place to a limited extent given that the consumers that demand and can afford high quality and priced EU T&A products are still limited.

Table 16: Vietnam's Top Apparel Import Countries

| Country/<br>Region | Value (million USD) |            |            |            | Share (%)   |             |             |             |
|--------------------|---------------------|------------|------------|------------|-------------|-------------|-------------|-------------|
|                    | 2000                | 2005       | 2010       | 2015       | 2000        | 2005        | 2010        | 2015        |
| <b>WORLD</b>       | <b>434</b>          | <b>260</b> | <b>289</b> | <b>488</b> |             |             |             |             |
| China              | 11                  | 26         | 131        | 301        | 2.6         | 10.1        | 45.5        | 61.7        |
| Korea, Rep.        | 119                 | 60         | 32         | 47         | 27.5        | 23.1        | 11.1        | 9.6         |
| Other Asia, nes    | 103                 | 41         | 19         | 21         | 23.7        | 15.9        | 6.6         | 4.4         |
| Japan              | 118                 | 69         | 32         | 17         | 27.2        | 26.4        | 11.2        | 3.6         |
| Thailand           | 8                   | 2          | 7          | 16         | 1.8         | 0.9         | 2.3         | 3.3         |
| Unspecified        | 0                   | 0          | 1          | 15         | 0.0         | 0.0         | 0.5         | 3.1         |
| Hong Kong, China   | 40                  | 38         | 15         | 15         | 9.2         | 14.7        | 5.1         | 3.0         |
| Italy              | 2                   | 2          | 4          | 8          | 0.6         | 0.7         | 1.3         | 1.6         |
| <b>Top 5</b>       | <b>359</b>          | <b>234</b> | <b>239</b> | <b>403</b> | <b>82.8</b> | <b>90.2</b> | <b>82.8</b> | <b>82.6</b> |

Notes: Apparel defined as HS 61 and 62.  
Source: UN Comtrade 2017

## Investment

It is expected that the EVFTA will lead to increased investment in T&A production but this is largely driven by improved market access and for textile also related to the restrictive RoO. The impact of improved investment security related to the chapter on investment and the dispute settlement mechanism does not seem to be important. It was only mentioned that for smaller less experienced foreign investors this improved protection mechanism could make investments in Vietnam more attractive.

## Policy space issues

The perception on declined policy space related to the EVFTA differed a bit but was mostly seen as not particularly relevant for the T&A sector. On the one side, it was stated that policy space has already been reduced with the entry into the WTO in 2007. For the T&A sector policies have already become less interventionist since 2007 as general level policies have been favored over sector specific selective policies. Specific support policies are linked to particular challenges such as location in rural areas or missing segments such as fabric and finishing in the T&A sector but do not target the whole sector. It was also stated that there is still space for support policies but that the government has to be more creative in its approach to support industries. On the other side, reduced policy space was seen as being positive in terms of pushing further reforms. In particular, more equal treatment between SOEs and private firms is seen as positive among private-owned firms. The limited scope to regulate FDI and force them to link with local producers or suppliers is considered more problematic, given that this limits a potentially important learning channel for locally owned firms.

## Sustainability chapter

The sustainability chapter of the EVFTA is important for the T&A sector. The chapter particularly focuses on labor rights and working conditions with a focus on the implementation of the ILO core conventions. Such issues are highly relevant in the global apparel sector, and also in Vietnam. Even though global buyers have taken compliance with labor standards central in their sourcing decisions and many global buyers have developed codes of conducts (CoC) that include labor standards and conduct regular audits, such CSR

measures tend to be selective and may be in contradiction to the core sourcing requirements of buyers that demand low prices, high quality, short lead times and high flexibility (see Plank et al. 2014). Hence, the creation of institutional structures including government, private sector and civil society actors as envisaged in the sustainability chapter could provide important improvements to traditional supplier country national laws and regulations that often suffer from lack of enforcement as well as private sector driven CSR initiatives. As these mechanisms should involve both EU and partner country actors, they could become particularly effective in comprehensively dealing with labor issues and related competitive dynamics and sourcing requirements along apparel GVCs.

With 2.5 million people employed, the T&A sector is the largest provider of formal employment in Vietnam. Estimates indicate that the share of women working in the Vietnamese T&A export sector is as high as 80%, while in the whole economy they account for about 44% of the workforce (ILO 2010). Official statistics from Vietnam's General Statistics Office report a female employment share of 83% in the apparel sector, and of between 64% and 69% in the textile sector in the early 2010s. Vietnam has a comparatively strict labor code that protects workers' rights. However, a problem is that many workers as well as entrepreneurs do not know about and understand their rights' as stipulated in the labor code. In addition, enforcement is a key issue as capacities of labor inspectorates are very limited (see below). Hence, main labor issues in the apparel sector in Vietnam include excessive overtime, low wages that do not correspond to a living wage, non-existence of independent trade unions and hence freedom of association (FoA) and collective bargaining (CB), non-complying labor contracts, gender discrimination and problematic occupational safety and health issues related to fire, safety and equipment.

The Vietnamese national labor law allows for 300 hours overtime per year (the general limit is 200 but 300 is allowed in special cases). Firm representatives complain that this is too low as flexibility in buyers' orders requires work time flexibility at suppliers. The average overtime in the sector is around 400-500 hours. Reducing this requires improving production management and increasing the productivity of workers. But it would also require that buyers change their sourcing practices in terms of reducing short-termism and flexibility in their orders and in changing requirements of their orders such as material and lead times. Currently there is a new labor law under discussion, which proposes to increase allowed overtime to a maximum of 600 hours per year. Firm representatives see this as positive, whereas labor representatives complain that this is too high.

There has been a minimum wage since 2012 set by the National Minimum Wage Council, which is staffed based on tripartite principles – 5 representatives from the trade union (VGCL), 5 representatives from employers' associations and 5 representatives from the government, i.e. the Ministry of Labor (MOLISA). Representation is based on employment quantity; on the employers' side, there comes therefore one representative each from VCCI, the Cooperative Association, VITAS (textile and apparel), LEVASO (leather and footwear) and the SME Association. Wages increase annually and increases are dependent on productivity, consumer price inflation and developments in other production countries. In 2015 wages increased by 15.4%, in 2016 by 12.4% and in 2017 by 7.3%. There is a minimum wage for SOEs and one for private firms. For private firms, there are four regional minimum wages with region 1 around HCMC and Hanoi having the highest wage of VND 3,750 million that is around USD 150 and region 4 in the mountains having the lowest wage with around VND 2,580 million. SOEs have lower wages of VND 1,200 million, which is around USD 60. The actual wage is the minimum wage times a coefficient, which is higher for SOEs making the overall wages less different from each other. There are different grades depending on the skills of workers. Allowances are also added to wages, including overtime allowances and productivity bonuses. Average wages are around USD



300-400 per month and workers can earn USD 450-500 when productivity is high and USD 250-300 when productivity is low. There are widespread complaints that these wages are not enough to allow for a living wage. In this context workers also need and want to work overtime to increase their wages – but workers are against excessive overtime and would prefer higher wages without overtime.

A key issue – not only in the T&A sector but more generally in the Vietnamese economy – is the lack of independent trade unions and hence of freedom of association and collective bargaining. There is only one trade union in Vietnam – the Vietnam General Confederation of Labor (VGCL) – that is closely linked to the communist party. This trade union has an important role in the industry – more important compared to other key lower-income country apparel suppliers – but its capacity to negotiate and represent is still low and collective bargaining agreements (CBA) are not established. In the currently discussed new labor law, there is a proposal to allow for independent workers' representation. This change has been triggered by the TPP negotiations, as TPP demanded that certain labor rights issues, particularly FoA and CB, have to be implemented before the ratification of the agreement. With the failure of the TPP, pressure has been reduced to tackle this issue. Thus it has to be seen how the final labor code will look like, and most importantly, how this potentially new legislation will be implemented. The interviews during the field research have shown that worker representatives are optimistic about the potential impact on FoA. The concern is nevertheless that FoA may undermine the power of labor, in case newly established labor unions are not well organized and/or owners and managers try to undermine their role ('yellow unions').

The Ministry of Labor and the labor inspectorates tend to know the main challenges in the T&A sector and the economy more generally. Resources are however limited, which makes enforcement challenging. According to our interviews, there are 400-500 inspectors for 50,000–60,000 enterprises in Vietnam – so it is impossible to cover all firms. To deal with this, the labor inspectorates send self-assessment forms to firms. Upon the return of the forms, firms are selected for inspection. The Better Work Programme has also operated in Vietnam since 2009. The program run by the ILO and the IFC aims to improve compliance with labor standards and raise the competitiveness of the Vietnamese apparel sector by assessing current workplace conditions and offering advisory and training services to factories. The initial focus of the program was Ho-Chi-Minh City and surrounding regions, but it expanded to the North in 2014. The program covers 410 firms that all export, covering roughly 20% of total apparel exports, and of which around 75% are FDI firms. Better Work has received large support from the government and the labor inspectorates, and cooperates particularly with the latter.

The sustainability chapter of the EVFTA can hence potentially play an important role in improving working conditions and labor rights in Vietnam's T&A sector. In contrast to the TPP that demanded changes in labor law prior to the ratification of the TPP and has therefore pushed discussions around the new labor code, the EVFTA puts its focus on dialogue and cooperation mechanisms. To ensure the effectiveness of such mechanisms and the ultimate implementation of labor clauses and of remedies for labor violations, a high level of involvement of all tripartite actors as well as broader civil society (independent from the government) will be required. This is particularly a challenge for civil society actors in Vietnam – given that civil society work on labor rights issues is still dominated by international NGOs – even though staff at these NGOs seems to be largely local – with only a limited but increasing number of local NGOs in this field. Strong civil society actors in Vietnam and the EU and strategic collaboration will be required in order to make dialogue mechanisms effective. Further, the governments of both partners including the labor ministries

and labor inspectorates, but also the Ministry of the Economy will need to take the sustainability chapter serious and enforce it. As might be expected, the government of Vietnam has so far not shown a strong interest in that respect. According to interviews with NGOs and sector experts in Vietnam, so far, however, it seems that the EU's willingness to use and enforce the chapter has been limited. It is important to change this attitude during the implementation phase of the agreement, as otherwise the potential of the sustainability chapter to contribute to improved development outcomes will remain unexploited. Evidence from EU FTAs where such chapters already exist, most importantly the EU-Korea agreement, tends to show that the impacts of the chapter have remained weak (see Campling et al. 2016). This mistake should not be repeated in the case of Vietnam.

#### **4.3.4. Conclusions and policy recommendations**

The T&A sector has an important role in Vietnam's economy and as a provider of export earnings and manufacturing employment, and has grown importantly since economic reforms started in Vietnam in the 1990s. FDI particularly from East Asia was important for export growth, but there is also a large share of locally owned firms – today overwhelmingly private ones – that are engaged in exporting. SOEs played an important role in the past, and also today (after equitization) the state still holds ownership mostly in the form of co-ownership with private investors. Factors explaining the rise of Vietnam's apparel export sector include more favorable market access to key apparel markets, a locational advantage in the Asian region, Vietnam's low labor costs combined with relatively high operator skills, as well as some important restructuring and upgrading processes which were also supported by targeted government policies. Challenges are the remaining focus on CMT, the large share of imported textiles related to the still limited development of the local textile and other supporting industries, concentration on relatively simple low value products, and a skill gap in particular with regard to technological, design/fashion, management and marketing skills.

The EU is a key end market accounting for 18% of total exports in 2015 – even though it is of significantly lower importance than the US, which has remained the dominant end market since the mid-2000s accounting for 46% of exports in 2015. The EVFTA provides important opportunities for the development of the T&A sector in Vietnam, most importantly in terms of duty free market access, supply chain upgrading and improved social and environmental standards. Currently Vietnam's apparel export products face on average tariffs of around 9% in the EU market. Hence, duty free access is an important advantage being stressed by all interview partners as the by far most crucial advantage of the EVFTA. Duty free market access for apparel exports to the EU can however only be used if the fabric forward RoO can be fulfilled, as well as if social and environmental compliance can be ensured. Both these conditions provide important upgrading opportunities for the T&A sector in Vietnam, also furthering its role in supporting sustainable development.

Fulfilling fabric forward RoO is challenging for Vietnam as currently still around 70% of apparel exports use imported textiles, and for the EU this share is probably even higher given the dominance of woven products in the EU market where local sourcing is lower compared to knit products. These RoO offer however an important opportunity to upgrade the local textile sector and to increase local sourcing and hence local value addition in Vietnam. The long-term liberalization periods however dampen this incentive. Developing the local textile sector will also lead to the generation of manufacturing jobs in a higher technology and skills context that may be more attractive for young Vietnamese graduates. FDI in textile production increased in the context of TPP and with the latter's failure these textile capacities may shift their focus to the EU market. But also local investment should be expanded, which will require government as well as development cooperation support



given the more capital- and scale-intensive nature of textile production and also the importance of fulfilling environmental standards particularly regarding waste water treatment. Linkages with FDI textile investments can be a relevant learning channel as local firms not only lack capital for textile investments but technology, skills and tacit knowledge to operate textile mills efficiently. Incentivizing such linkages by focusing on attracting and supporting FDI that has an interest in local value addition and linkages will be important.

On the social and environmental side, the sustainability chapter provides an important opportunity. Its formulation is however rather weak and its impact will therefore depend on the willingness of both the Vietnamese government as well as the EU to implement and enforce the chapter. Up to now, according to interviews with NGOs and sector experts in Vietnam, the EU has hardly shown such a willingness during negotiations, which is in stark contrast to the stronger political will of the US during the TPP negotiations but is also related to the different approaches of the EU and the US. The EU will need to shift its focus to the sustainability chapter and its implementation on a general level and particularly in terms of civil society involvement. A successful implementation does not only require political will, but also the involvement and support of civil society actors from Vietnam and the EU to engage in collaboration and dialogue mechanisms. Development cooperation could play a strategic role in supporting the trade union VGCL as well as broader civil society actors such as NGOs working on labor issues in participating in and using these mechanisms to support improved working conditions and increase the power of labor rights advocates in Vietnam and in T&A GVC more generally.

Overall, the T&A sector has to be seen as a strategic export sector in Vietnam to be used for learning and upgrading within the sector as well as beyond. Relying only on low-cost labor does not ensure sustained competitiveness even more so in the context of Vietnam, where labor costs are rising and other developing industries are competing for employment. It also does not ensure supporting sustainable development. Hence, Vietnam has to increasingly position itself as a more developed apparel supplier extending its role from CMT production and lower value products to increasing local value added and linkages. The fast developing domestic market and regional markets can play an important role in such upgrading strategies, as broader functions including design and branding are more easily available in these markets. For such upgrading paths, support will however be required particularly for the large majority of small and medium scaled local firms. Policy space for such support through the government or development cooperation has however been reduced which is problematic. It is particularly alarming that most actors see the reduction of policy space through the EVFTA and similar agreements as not problematic, even though the government has played a relevant role in supporting the sector to where it is today. Hence, there is the danger that in the context of the pro-reform support which goes along with reducing the role of the state in large parts of the private sector in Vietnam, the strategic role that the government has played in the past and will need to play in the future to ensure upgrading and structural transformation will be side-lined.

## 4.4. CASE STUDY II: Seafood Vietnam

The development of global fish value chains over the last decades is an example of value chains in which international food networks interlink low- and high-income countries. In particular the demand for high-value fish and seafood products for instance in EU member states, enabled the integration of low-income countries into buyer-driven food value chains. This participation requires strong capacities and capabilities in the private sector and related governmental institutions as well as political commitment and a legal framework in order to fulfill the sanitary and ecological standards set by EU institutions and international buyers.

In this section, we will discuss the current structure and challenges of as well as the impact of the EVFTA on the aquaculture sector in Vietnam. The aquaculture sector is of particular interest in the context of the EVFTA due to its economic and socio-economic importance in terms of growth and upgrading potential, value generation and employment as well as its strong export orientation. In terms of growth, upgrading and sustainability aspects, it offers better development potential than captured fish in Vietnam. Particularly tuna – the main captured export fish – faces serious sustainability challenges related to overfishing, which makes a strategy to develop exports highly questionable. The two main aquaculture segments – pangasius and shrimp – have similarities but also important differences, particularly with regard to the role of smallholders, vertical integration of processors, international competition as well as growth and upgrading potentials with important implications for the potential impact of the EVFTA.

The sectoral case study of the pangasius and shrimp sector in Vietnam shows the importance of the specific sector and value chain dynamics in understanding the prospect to benefit from DFQF market access to the EU. Development implications of the EVFTA for the Vietnamese aquaculture sector depend importantly on regulatory changes due to the EVFTA. However, the analysis of the latter has to be done in combination with the assessment of competitive business dynamics within the shrimp and pangasius GVC, as well as differences in their respective governance structure and local conditions.

This section starts with an overview of the development of the global fish and seafood value chain. Thereafter, dynamics in the Vietnamese shrimp and pangasius sector are presented, including main developments and current challenges. Based on this analysis, we discuss the potential impact of the EVFTA on the further development of the sector, also highlighting differences between the shrimp and pangasius sector. We conclude by examining the development implications of the EVFTA and potential upgrading opportunities in the aquaculture sector in Vietnam.

### 4.4.1. The global seafood value chain<sup>17</sup>

The global consumption of fish and seafood increased steadily over the last decades from less than 12 kilogram per capita and year in 1980 to 19 kilogram in 2013 (FAO 2017). This process was enabled by a dynamic development in production and trade in fish and fish products with production volumes tripling and export volumes increasing by a factor of 15 in the period from 1980 to 2014 (FAO FishStatJ 2017). Average export prices of fish and seafood products per kilogram increased simultaneously, which – in combination with higher volumes – made fish and seafood the most important food commodity by export value (Asche et al. 2015).

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<sup>17</sup> Parts of this section on the global value chain dynamics of seafood are based on Grumiller et al. (2018).

Despite these increasing trends in international fish production, trade and consumption, a disaggregated perspective reveals a more diversified picture, in particular in consumption patterns (Béné et al. 2009).<sup>18</sup> While production (catch and aquaculture) has been dominated by Asian countries, high-income countries (in particular the EU) are the major exporters and importers, accounting for more than half of global trade in value (Table 17). However, actors in low- and middle-income countries such as China, Vietnam, Senegal or Uganda have been increasingly integrated in fish and seafood GVCs. This also includes artisanal fishers in these countries. Thus, various institutions and scholars promote the fishery sector as a potential engine of growth, source of foreign exchange earnings and as an instrument for poverty alleviation in developing countries, if managed correctly (Willmann/Kelleher 2009; FAO 2016). The development of the fishery sector with the aim to increase trade faces however potentially conflicting fields of interest concerning sustainability, food security and welfare creation, which is a challenge for fisheries management (Nunan 2014).

*Table 17: Trade in fish and fish products by regional and income groups 2015*

| <b>Exporter</b>        | 1) EU         | 2) Low income | 3) High income | 4) Upper middle income | 5) Lower middle income | Others       | <b>Exports</b> | <b>Net Trade</b> |
|------------------------|---------------|---------------|----------------|------------------------|------------------------|--------------|----------------|------------------|
| <b>Importer</b>        |               |               |                |                        |                        |              |                |                  |
| 1) EU                  | 18,834        | 66            | 2,535          | 754                    | 589                    | 65           | <b>22,842</b>  | <b>- 21,995</b>  |
| 2) Low income          | 516           | 56            | 282            | 197                    | 151                    | 2            | <b>1,203</b>   | <b>826</b>       |
| 3) High income         | 12,244        | 40            | 15,770         | 6,666                  | 1,035                  | 408          | <b>36,162</b>  | <b>- 13,459</b>  |
| 4) Upper middle income | 7,193         | 137           | 18,699         | 5,496                  | 1,235                  | 315          | <b>33,074</b>  | <b>16,507</b>    |
| 5) Lower middle income | 5,873         | 78            | 11,306         | 2,896                  | 1,066                  | 317          | <b>21,537</b>  | <b>17,296</b>    |
| <b>Others</b>          | 176           | 1             | 1,030          | 559                    | 164                    | 1            | <b>1,932</b>   | <b>824</b>       |
| <b>Imports</b>         | <b>44,836</b> | <b>377</b>    | <b>49,621</b>  | <b>16,568</b>          | <b>4,240</b>           | <b>1,108</b> | <b>116,750</b> |                  |

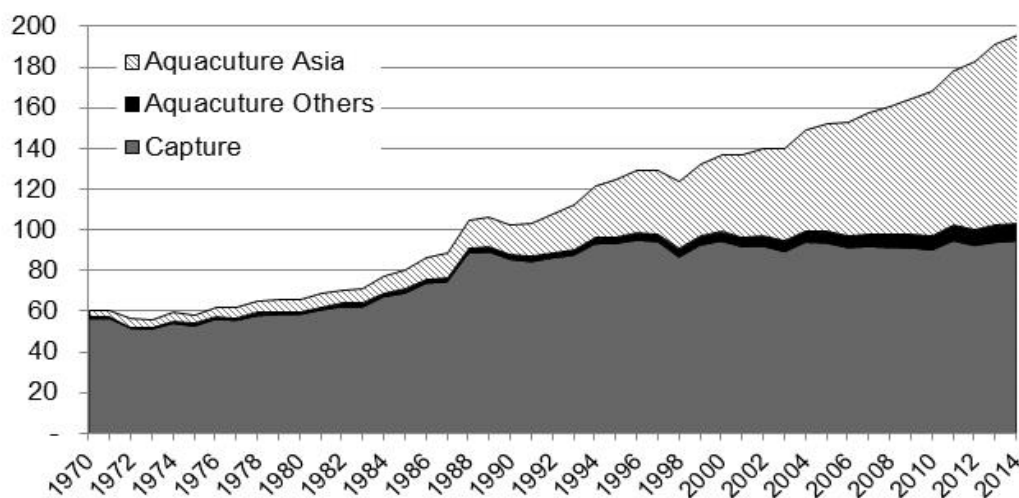
Notes: in million USD; Includes HS 03, 1604 and 1605.

Source: UN Comtrade 2017

Global production in fish and seafood has changed drastically in the last four decades. A first trend is the increase in global production from 65 million tons in 1980 to 195 million tons in 2014. This development unfolded particularly in the context of more regulated traditional fish catching in the North Atlantic and Pacific as well as major capacity increases in aquaculture production, mainly in Asia (Gibbon 2001). Hence, a second trend is the geographic shift in production patterns, with Asia became the dominating area of production as 75% of total fish and seafood production originated mainly from South-East Asia in 2014 (compared to around 50% in the 1970s and 1980s). A third trend is the increasing share of aquaculture, with aquaculture production now being the major type of fish and seafood production, accounting for 52% of global production, of which 92% is based in Asia (Figure 11). In the context of overfished maritime resources and a relatively static draft since the late 1980s, aquaculture is considered as increasingly important for global food security (FAO 2016).

<sup>18</sup> Regional dynamics in fish and seafood consumption differ significantly. Per capita supply in Eastern Asia almost tripled to 36 kg/year between 1980 and 2013. In the same time period, supply per capita in Southern and Eastern Africa declined by 25% to 6.1 and 4.8 kg/year, respectively (FAO 2017).

Figure 11: Production of fish and seafood by type and area (in million tons)



Source: FAO FishStatJ 2017

It is likely that future growth in fish and seafood production will mainly originate from aquaculture, making the question of how sustainable aquaculture production can be achieved all the more important. FAO (2016: 182) identifies the following key challenges for sustainable aquaculture production: (i) land and water access and associated conflicts; (ii) feed, seed supply and genetic resources; (iii) environmental integrity and disease problems; (iv) development and adoption of new and improved farming technologies; (v) market, trade and food safety; (vi) climate change; (vii) investment capital impediments; and (viii) problems originating from unguided and unmonitored aquaculture practices.

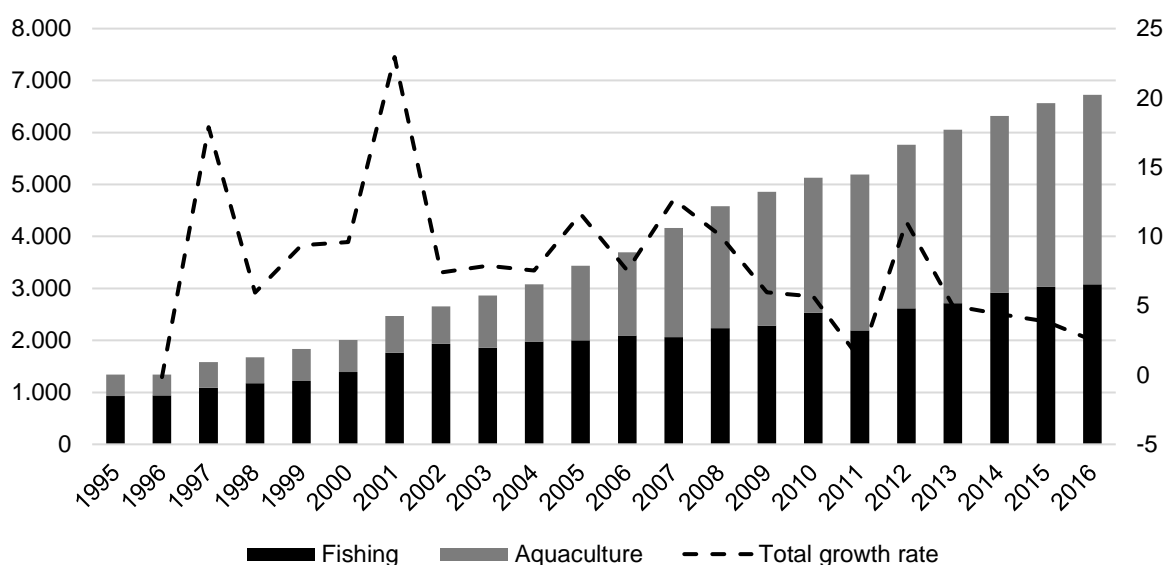
#### 4.4.2. Seafood in Vietnam

Vietnam has a long history of seafood production, however, production increased significantly in the 1990s in the context of the shift to export orientation under Doi Moi reforms (Figure 12). Seafood production in Vietnam includes fishing as well as aquaculture production. While the aquaculture sector was nearly inexistent some 20 years ago, it accounts for the majority of fish production today. The aquaculture sector accounts for 54% of total seafood production and is dominated by shrimp and pangasius production. Fishing production accounts for 46% of total seafood production and includes marine as well as inland capture; however, marine capture (esp. tuna) is by far more important (VASEP 2017a). Growth of the seafood sector was largely driven by the aquaculture sector, which increased almost nine fold in the last 20 years from 415 thousand tons in 1995 to 3650 thousand tons in 2016 (VASEP 2017b). Fishing production, on the other hand, 'only' tripled during the same time period (Table 18).

Today, the seafood sector disposes of a labor force of around 4 million direct employees and additionally up to 4 million people that indirectly receive their main income from the sector. The sector contributes 4-5% to GDP, accounts for 9-10% of total export turnover and ranks 5<sup>th</sup> in terms of export value (VASEP 2017b). The sector also has an important role for food security. The sector is further highly relevant from an ecological perspective. While the coastal areas tend to be overfished, which is particularly relevant for tuna (DERG/CIEM 2010; Worldfishing 2016), questions of water quality, use of drugs and feed, and the related impacts on fish and nature are the most important challenges for aquaculture (Nguyen et al. 2016). Since the classification of Vietnamese pangasius with the label "Do not Buy" by the international NGO WWF in 2010 due to ecological and sustainability

concerns and related negative campaigning of European NGOs and the media, initiatives have been taken to improve ecological and quality aspects of seafood production (see below particularly for pangasius). The government of Vietnam sees the seafood sector, and in particular aquaculture, as a priority sector. The Ministry of Agriculture and Rural Development (MARD) is the most important governmental unit in terms of industrial policy implementation in this sector (Vietnam Briefing 2015).

Figure 12: Vietnam's seafood production (1995-2016)



Source: VASEP 2017b

Table 18: Vietnam's seafood production (2016)

|                                  | Output<br>(thousand t) | %-share of to-<br>tal output | Area<br>(thousand ha) |
|----------------------------------|------------------------|------------------------------|-----------------------|
| <b>Fishing production</b>        | <b>3,076</b>           | <b>45.7</b>                  |                       |
| <i>Marine capture</i>            | 2,876                  | 42.8                         |                       |
| <i>Inland capture</i>            | 200                    | 3.0                          |                       |
| <b>Aquaculture production</b>    | <b>3,650</b>           | <b>54.3</b>                  |                       |
| <i>Brackish water shrimp</i>     | 650                    | 9.7                          | 700                   |
| <i>Mekong River Delta shrimp</i> | 504                    | 7.5                          | 634                   |
| <i>Pangasius</i>                 | 1,150                  | 17.1                         | 5                     |
| <i>Other</i>                     | 1,346                  | 20.0                         | -                     |
| <b>TOTAL</b>                     | <b>6,726</b>           | <b>100</b>                   |                       |

Notes: Totals may differ due to rounding

Source: VASEP 2017a: 6

Only a small share of seafood production is consumed domestically; the large majority is exported. In 2016, Vietnam exported seafood products to 160 markets for a total amount of USD 7.16 billion, an increase of 7.3% compared to 2015. Shrimp, especially the white-leg variety, are the most important seafood export product (44%), followed by pangasius (24%), tuna (7%) and mollusks (7%) (Table 19). The US is the most important export market (20%), followed by the EU (17%), Japan (15%) and China (12%) (Table 20). China is the by far fastest growing market for Vietnamese seafood exports, which only recently

increased in importance with a 40% increase in exports only between 2015 and 2016 (Table 20). The growth of seafood exports to the EU in general has been moderate in recent years (4% between 2015 and 2016).

Table 19: Vietnam's seafood exports by product (2016)

|                                     | Export value<br>(million USD) | %-share of total sea-<br>food exports |
|-------------------------------------|-------------------------------|---------------------------------------|
| <b>Shrimp</b>                       | <b>3,151</b>                  | <b>44.0</b>                           |
| <i>Whiteleg shrimp</i>              | 1,958                         |                                       |
| <i>Black tiger shrimp</i>           | 931                           |                                       |
| <b>Pangasius</b>                    | <b>1,715</b>                  | <b>23.9</b>                           |
| <b>Tuna</b>                         | <b>510</b>                    | <b>7.1</b>                            |
| HS03 (fresh, fillet, etc.)          | 284                           |                                       |
| HS16 (canned tuna)                  | 226                           |                                       |
| <b>Mollucks</b>                     | <b>524</b>                    | <b>7.3</b>                            |
| <b>Crab &amp; other crustaceans</b> | <b>125</b>                    | <b>1.7</b>                            |
| <b>Other marine fish</b>            | <b>1,139</b>                  | <b>15.9</b>                           |
| <b>TOTAL</b>                        | <b>7,162*</b>                 | <b>100</b>                            |

Notes: \*Own calculation; totals may differ due to rounding.

Source: VASEP 2017a: 9

Table 20: Vietnam's seafood exports by country (2016)

|            | Export value<br>(million USD) | %-share |              | Export value<br>(million USD) | %-share    |
|------------|-------------------------------|---------|--------------|-------------------------------|------------|
| USA        | 1,454                         | 20.3    | South Korea  | 617                           | 8.6        |
| EU         | 1,219                         | 17.0    | ASEAN        | 526                           | 7.3        |
| <i>NL</i>  | 210                           | 2.9     | Australia    | 191                           | 2.7        |
| <i>UK</i>  | 206                           | 2.9     | Canada       | 187                           | 2.6        |
| <i>GER</i> | 181                           | 2.5     | Russia       | 98                            | 1.4        |
| <i>ITA</i> | 138                           | 1.9     | Brazil       | 69                            | 1.0        |
| <i>BEL</i> | 127                           | 1.8     | Others       | 837                           | 11.7       |
| Japan      | 1,105                         | 15.4    | <b>TOTAL</b> | <b>7,162*</b>                 | <b>100</b> |
| China      | 860                           | 12.0    |              |                               |            |

Notes: \*Own calculation; totals may differ due to rounding.

Source: VASEP 2017a: 12

Processing in the seafood sector has generally increased. Low labor costs in Vietnam are a factor contributing to this development. According to VASEP, there were 570 processing plants active in 2014, of which 447 had the licence to export to the EU. This is quite an increase compared to only 17 existing in 2000. The share of processed seafood products accounted for 45% of production and exhibited an increasing trend (Worldfishing 2016). There are however important differences product-wise, particularly related to processing possibilities of different seafood types, strategies of seafood importers and the existence of processing capacities in importer countries (see below for shrimp and pangasius).



### **4.4.3. Aquaculture in Vietnam**

The aquaculture value chain for pangasius and shrimp in Vietnam can be roughly divided into five stages: (i) input supply of seed, feed and drugs; (ii) production of pangasius or shrimp; (iii) purchase and transportation of the produce to processors and other local buyers, organized either by the processors themselves or by middlemen and traders (collectors, wholesalers and trading companies); (iv) the processing of pangasius or shrimp to various low value-added (e.g. frozen, head- or tailless shrimp and pangasius filet) or high value-added products (e.g. ready-to-eat products) in Vietnam or importing countries; and (v) distribution and marketing of the processed products at the domestic and international level, with supermarkets being the most important players in the export market. In the following the development and main characteristics as well as challenges of, firstly, the shrimp sector and, secondly, the pangasius sector are discussed, given important differences in their value chain in terms of main actors, geographical distribution of activities and development potentials in terms of growth and upgrading, most importantly their processing potential.

With regard to regulation, the Vietnamese seafood sector is regulated by the 2003 Fishery Law, where sections for aquaculture stipulate land and marine leases, waste water use and feed standards. Land lease regulation provides long and renewable leases and therefore security for farmers. Generally, the lack of capacity to monitor and enforce existing regulations is named as a main concern, leading to unsustainable practices in aquaculture (DECRG/CIEM 2010: 39). Nevertheless, change is observable, largely related to standards of importing countries and buyers' requirements and certification. Hence, concerns of end-users about food safety, but also about environmental and social impacts of production are increasingly communicated to exporters. Ongoing issues, particularly related to quality and sustainability of Vietnamese pangasius, illustrate the importance of international certification schemes (see below).

One of the most important certifications for aquaculture is the one issued by the Aquaculture Stewardship Council (ASC). It focuses on both environmental and social impacts of farming. Environmentally, farms must show that they actively minimise their impact on the surrounding natural environment, which extends to the careful management of fish health and resources. ASC certification focuses on biodiversity, feed, pollution and diseases. Socially, farms must be good and conscientious neighbours, operating their farm in a socially responsible manner, caring for their employees and working with the local community (ASC n.d.a). Currently 37 Vietnamese pangasius farms and 31 shrimp farms are listed as certified at the ASC's website (ASC n.d.b). In addition to the ASC certification scheme, the BAP (Best Aquaculture Practices) certification standards and the GlobalG.A.P (Global Good Agriculture Practice) are relevant.

In 2008, the Ministry of Agriculture and Rural Development issued the certification scheme VietGAP (Vietnamese Good Agriculture Practices). On the 20<sup>th</sup> June 2014 a degree came into force, which obliges all commercial fish farms to be certified by VietGAP or any other international certifications by the end of 2015 (VASEP n.d.b.).

#### **4.4.3.1. Shrimp**

Shrimp growing in Vietnam dates back over 100 years and is mainly located in the Mekong Delta (83% of total farming output in 2016) (VASEP 2017a: 21). In 2016, Vietnam produced 609,000 tons of shrimp by cultivating a farming area of 673,000 hectare. The black tiger shrimp used to be the main cultivated shrimp variety, which is mainly cultivated in extensive farms. But today, the white-leg shrimp mainly used for intensive farming makes up

nearly 59% of total shrimp output<sup>19</sup> and 62% of total shrimp exports<sup>20</sup> (VASEP 2017a: 21f.). The shift from black tiger to white-leg shrimp has been driven by fewer production problems and higher productivity in white-leg shrimp farming (OECD 2008). The growth of shrimp production increased significantly in the 1990s in the context of technological advancements as well as trade liberalization policies (UNIDO 2013), and continues to be the most promising seafood sector in terms of growth potential. In 2016, with an export value of USD 3.15 billion, shrimp accounted for 44% of Vietnam's total seafood exports, representing a 31% increase compared to 2011 (Table 19; VASEP 2017b).

Today, shrimp is exported to 93 countries around the world, with the US (23%), the EU (19%), Japan (19%) and China (14%) being the largest export markets by value (Table 21). The US is the largest importer of Vietnamese shrimp, despite a currently applied anti-dumping duty. Demand in most export destinations is still growing, particularly in China with a 24% growth rate compared to 2015 and South Korea with 14%, followed by the EU with 9% and the US with growth rate of 8%. The US is the largest importer of Vietnamese white-leg shrimp, and China the largest importer of black tiger shrimp (VASEP 2017: 24). The main export products are frozen shrimp, canned shrimp and other processed shrimp (headless, tailless, peeled, breaded, ready-to-eat products etc.). Hence, particularly in comparison to the pangasius sector, higher value-added processed products are also exported in the shrimp sector. This is related to several reasons: firstly, to product characteristics of shrimp, which is per se a higher value added seafood product and hence allows for more processing possibilities, and secondly, strategies of shrimp importers that prefer processing in export countries due to lower labor costs and due to lower processing capacities in importing countries. The latter is different for fish processing, where important processing capacities exist in importing countries and particularly for lower value-added fish products that are often mixed with fish coming from other locations.

Table 21: Vietnam's shrimp exports by country (2016)

|             | Export value<br>(million USD) | %-share |              | Export value<br>(million USD) | %-share    |
|-------------|-------------------------------|---------|--------------|-------------------------------|------------|
| USA         | 709                           | 22.5    | Australia    | 115                           | 3.7        |
| EU          | 600                           | 19.1    | Canada       | 123                           | 3.9        |
| UK          | 136                           | 0.4     | ASEAN        | 56                            | 1.8        |
| NL          | 131                           | 0.4     | Taiwan       | 51                            | 1.6        |
| GER         | 111                           | 0.4     | Switzerland. | 33                            | 1.1        |
| Japan       | 600                           | 19.0    | Others       | 144                           | 4.6        |
| China       | 436                           | 13.8    | <b>TOTAL</b> | <b>3,150</b>                  | <b>100</b> |
| South Korea | 285                           | 9.0     |              |                               |            |

Notes: Totals may differ due to rounding.

Source: VASEP 2017a: 23f.

The value chain for shrimp in Vietnam includes input suppliers, shrimp farmers, middlemen and processors. Outside of Vietnam, key players include processors, importers, distributors and supermarkets.

**Input suppliers** include sellers of inputs (feed and antibiotics) as well as fishermen who catch wild shrimp broodstocks and sell them to shrimp hatchery and nursery farmers that supply seed to farmers (UNIDO 2013: 76ff.). The number of hatcheries in Vietnam has decreased significantly in the last decade, with around 1,500 hatcheries existing today.

<sup>19</sup> Excluding marine shrimp.

<sup>20</sup> Including marine shrimp. Marine shrimp accounts only for 8.3% of total exports.

Their total output of postlarvae has however increased due to upscaling and modernization. The shrimp sector nonetheless suffers from a lack of local supply of high quality seed and broodstock (Rurangwa et al. 2016: 13ff.), severely limiting the survival rate in shrimp production and thus income of farmers. According to interviews with actors in the shrimp sector, the survival rate of shrimp in the production process in Vietnam could be doubled, if the quality of seed and feed input were to be enhanced.

**Shrimp production** in Vietnam provides a livelihood to around one million people, and is dominated by independent smallholders farming cultivating shrimp in the Mekong Delta. Marine shrimp represents only 8.3% of total shrimp exports by value (VASEP 2017a: 22). Growing shrimp takes about four months and the main shrimp crop starts in January and ends in May (UNIDO 2013: 77). Shrimp production can be differentiated according to the degree of intensity (referring to use of labor, capital, seed, fertilizer and feed), which is related to different farming systems (Clay 1996). Shrimp farming systems include rotational rice-shrimp farming (around 27% of total hectares cultivated), integrated mangrove-shrimp farming (8%), improved-extensive (55%) and intensive farming (10%) (Hai et al. 2014). The first two farming systems can also be cultivated intensively, but largely fall under extensive farming. Extensive farms generally have a lower stocking density, lower survival rates and lower yields, compared to intensive farms (Le et al. 2011). Intensive (and also semi-intensive) farming requires more investment and is adopted by large companies with several hundred hectares, but also by small households with farms of one to three hectares. The high stocking density leads to higher yields and higher survival rates, but makes shrimp also more prone to diseases, increasing the need for antibiotics and related risks in terms of survival rates. In rotational or integrated farming systems, where shrimp is planted together with other products, overall risk is lower as farmers' incomes depend not solely on shrimp production. In general, the environmental impact of intensive shrimp farming is considerably larger.

Independent small-scale farmers dominate shrimp farming in Vietnam. Contract farming so far plays only a very limited role. Independent small-scale farmers generally do not have a very well-developed and/or managed production system, limiting their yields and income (Rurangwa et al. 2016). Investments in new technologies such as biofloc recirculation systems or optimized aeration to increase productivity are often not affordable or suitable for small-scale farmers. Farmer-based organizations (FBOs) are not widespread and 'communes' face the challenge to form legal entities ('cooperatives') under the cooperative law in order to be able to sign contracts (e.g. to engage in contract farming). Farmers organized in FBOs tend to be more productive, since they are more likely to gain access to capability building mechanisms as well as finance, in particular by engaging in contract farming. Contracted farmers also benefit from being able to sell shrimp directly to processors as well as by enhanced access to inputs, training and finance.

The biggest challenge for shrimp farmers are crop failures and low survival rates due to various diseases (such as white spot, monodon baculovirus, necrotising hepatopancreatitis, fungal diseases and others) and environmental changes. Shrimps are very sensitive to rapid changes in the environment (e.g. temperature, salinity level), which makes them vulnerable to climate changes (such as heavy rain) or other phenomena, such as the changing salinity level in the Mekong river due to dams in China. The high risk involved in shrimp farming makes shrimp farmers particularly vulnerable to income shortfalls. Other key challenges include the price volatility of shrimp and (imported) feed, access to credit and training, implementing certification according to buyer's demands, weak negotiation power vis-à-vis processors and intermediaries, lacking quality control mechanisms and difficulties to establish meaningful FBOs.

**Middlemen** in the shrimp value chain are the link between the processors and the farmers in cases where the processors do not produce shrimp themselves or buy them directly from the farmers. Middlemen include collectors as well as wholesalers and sometimes also the same companies that provide input supplies (Le et al. 2011; UNIDO 2013: 77). Data from 2010 in the Tra Vinh province suggests that around 67% of shrimps are routed to processors via middlemen (Le et al. 2011). Middlemen play a crucial role in the value chain due to the limited vertical integration of processors and limited existence of contract farming. They are however blamed by some actors for deteriorating the quality of the shrimp due to malpractices and fraud with the aim to increase the weight of shrimps. Selling shrimp via middlemen also impedes traceability of shrimp for certification purposes. Middlemen generally do not have the capacity and capability for in-depth quality control and sometimes rely on collaborating with quality control teams of processors.

**Shrimp processing** in Vietnam consists of roughly 200 companies that are engaged in this labor intensive activity, with the top-ten exporters having a share of nearly 41% in total shrimp exports in 2016 (Table 22). There is no exact data on employees in the processing sector. The largest and vertically integrated company Minh Phu with a share of nearly 10% of total shrimp exports has around 12.000 employees. The vertical integration of shrimp processors is increasing, while smallholders continue to dominate the production of shrimp. Shrimp processors are represented by VASEP.

Table 22: Top 10 largest shrimp exporters of Vietnam (2016)

|                  | Shrimp export turnover<br>(2016, USD) | %-share of total sea-<br>food exports | %-share of total<br>shrimp exports |
|------------------|---------------------------------------|---------------------------------------|------------------------------------|
| Minh Phu Seafood | 312,740,471                           | 4.4                                   | 9.9                                |
| Stapimex         | 222,975,473                           | 3.2                                   | 7.1                                |
| Quoc Viet        | 161,012,179                           | 2.3                                   | 5.1                                |
| Trang Khanh      | 140,744,543                           | 2.0                                   | 4.5                                |
| Fimex VN         | 132,079,401                           | 1.9                                   | 4.2                                |
| Thuan Phuoc      | 76,547,322                            | 1.1                                   | 2.4                                |
| Vina Cleanfood   | 68,540,420                            | 1.0                                   | 2.2                                |
| UTXI             | 56,671,811                            | 0.8                                   | 1.8                                |
| Auvung Seafood   | 55,098,914                            | 0.8                                   | 1.7                                |
| Sea Minh Hai     | 50,805,879                            | 0.7                                   | 1.6                                |

Source: VASEP 2017a: 35

The main challenges of the shrimp processing sector are closely connected to the challenges in shrimp production, since the supply of quality shrimp can be limited in times of high shrimp death rates and related to seasonality. Other challenges include the high cost of finance, price and exchange rate volatility, quality control in general, the so far limited valorization of waste (e.g. chitin and chitosan production used for animal feed, packaging and medicine, see Rurangwa et al. 2016: 16) and global competition (e.g. India, Indonesia, Thailand, Ecuador). In order to tackle the lack of local supply during specific periods, shrimp processors also import shrimp from India (70% of total imports of USD 376 million to Vietnam in 2016, VASEP 2017a: 38) and other producer countries for further processing.

A National Action Plan of the Ministry of Agriculture and Rural Development (MARD) and its General Department of Fishery is currently under development and aims at boosting shrimp exports significantly to USD 10 billion by 2025 (compared to USD 3.15 billion in 2016). This shall be achieved by upgrading irrigation systems, improving the availability of electricity in shrimp regions and by reorganizing small production facilities, e.g. by forming

cooperatives, in order to enhance their market access to input suppliers and processors (VASEP 2017c). The plan also discusses the importance of investment in marketing and research and development in areas such as shrimp quality, technology for higher value added products and shrimp feed to expand local production. At the time of writing, it remains unclear which concrete policies will be implemented. While most actors interviewed in the shrimp sector agree with the broad policies suggested, the high export objective is at least partly seen as problematic, as it may privilege quantity over quality. Doing this can be very problematic in the seafood or any food sector, where health and safety standards play an important role, as quality and sustainability issues can quickly destroy the export image of a country, the latter being illustrated by the case of Vietnamese pangasius exports to the EU. Hence, from a sustainable development perspective, it will be important to support shrimp exports with a focus on quality and value addition, while taking into account social and sustainability issues. This will require focusing on smallholder farmers and their farming systems and their links to processors.

#### **4.4.3.2. Pangasius**

Vietnam is by far the largest exporter of pangasius, a low-value freshwater fish. Being able to cope with comparatively high salinity levels, it competes with other low-value white fish species around the world. Pangasius production in Vietnam started in the mid-20<sup>th</sup> century and almost exclusively takes place in the Mekong Delta. In 2016, Vietnam produced 1.19 million tons of pangasius within an area of 5.5 thousand hectares, thus illustrating the highly intensified production system in Vietnam (VASEP 2017a: 38ff.). Production for global exports beyond regional markets, however, only started in the 1980s and 1990s and only really took off in the 2000s. After the boom in the 2000s, the export growth of pangasius has however been sluggish in recent years. In 2016, pangasius accounted for 24% of total seafood export value, worth USD 1.7 billion compared to USD 1.8 billion in 2011 (Table 19; VASEP 2017b).

Vietnam's pangasius is exported to 138 countries around the world, with the US (23%), China (18%) and the EU (15%) being the largest importers by value (Table 23). China is by far the fastest growing market for pangasius (plus 89% compared to 2015), and in particular EU exports have suffered in recent years largely due to negative campaigning of European NGOs and the media regarding the sustainability of pangasius production in Vietnam (see below for more details). The most important export product is filet, which however adds comparatively little value compared to ready-to-eat products produced in importing countries. Exporters have struggled to increase the share of value-added export products, since many buyers in key importing countries have well-established processing facilities (e.g. to produce ready-to-eat products) as well as their own brands and distribution channels.



Table 23: Vietnam's pangasius exports by country (2016)

|       | Export value<br>(million USD) | %-share |              | Export value<br>(million USD) | %-share    |
|-------|-------------------------------|---------|--------------|-------------------------------|------------|
| USA   | 388                           | 22.6    | ASEAN        | 135                           | 7.9        |
| China | 305                           | 17.8    | Mexico       | 84                            | 4.9        |
| EU    | 261                           | 15.2    | Brazil       | 68                            | 4.0        |
| NL    | 48                            | 2.8     | Colombia     | 55                            | 3.2        |
| UK    | 45                            | 2.6     | Saudi Arabia | 51                            | 0.9        |
| ESP   | 44                            | 2.6     | Others       | 367                           | 21.4       |
| GER   | 28                            | 1.7     | <b>TOTAL</b> | <b>1,715</b>                  | <b>100</b> |

Notes: Totals may differ due to rounding.

Source: VASEP 2017a: 39

The value chain for pangasius in Vietnam includes input suppliers, pangasius farmers, middlemen, and processors. Outside of Vietnam, key players include processors, importers, distributors and supermarkets.

**Input suppliers** in the pangasius sector include suppliers of seed, feed and veterinary drugs. Seed producers (hatcheries) are mainly domestic, while foreign and foreign-owned companies play a major role in feed and veterinary drug supply (Khiem et al 2010; UNIDO 2013: 73ff.). Pangasius fry can be caught from the Mekong River, however, meanwhile the fry is mainly produced in hatcheries where the larvae is nursed for around 40 days. The fry is then nursed for another 80 days to become fingerlings, which are sold to the farmers (ibid.). Rurangwa et al. (2016: 10) argue that better broodstock management and standardized production procedures at hatchery and nursery levels as well as research in high quality seed and fingerling production could increase the survival rate of fingerlings and thus reduce production costs.

**Farmers** raise fingerlings all year around for about 6-8 months before harvest. Independent farmers used to dominate pangasius production, however, vertical integration of processors – largely by buying land from smallholders – in part due to the increasing quality and safety standards demanded by international buyers has reduced the role of independent farmers significantly. Today, vertically integrated processors and contract farmers are the main producers of pangasius. Smallholders that used to farm pangasius are now often employees of processors, supply larger producers or, depending on price differentials, also farm other fish species. Contract farmers are closely connected to processors and benefit from input supply and supporting services such as quality control and training. The vertical integration process has also reduced the role of intermediaries and furthered the intensification of pangasius production, allowing for higher yields per hectare, with negative environmental consequences due to wastewater disposal in the Mekong River. Small-scale farmers lack the resources to invest and compete with the highly intensified production of large companies and will likely completely disappear in the future. The waste water discharged by farms negatively affects production as water is exchanged between farmers, and more generally deteriorates the water quality in the Mekong River. Technical innovations, for example as implemented by the SUPA (“Establishing a Sustainable Pangasius Supply Chain in Vietnam”) project (see below), as well as improvements in the management of farms could improve the environmental impact of pangasius production.

A key challenge in pangasius production is the price of feed, since it accounts for up to 90% of the operating cost in pangasius production, followed by the cost of fingerlings and labor (Khiem et al. 2010; UNIDO 2013). The use of antibiotics has increased due to the



intensification of production, though quality management often in collaboration with processors generally ensures that buyers' demands and SPS standards are complied with. Independent as well as contract farmers have little negotiation power vis-à-vis processors, in part because they lack laboratories for testing quality, and depend on the latter's negotiating terms (UNIDO 2013: 75; Rurangwa et al. 2016: 11). Challenges to fulfill the demands of international buyers, especially certification and SPS requirements, has been reduced due to the vertical integration processes.

In the labor intensive **processing sector**, there are around 150 companies in Vietnam, with the top five exporters having a share of nearly 37% of total pangasius export value in 2016 (Table 24). The consolidation in the pangasius sector is thus more advanced than in the shrimp sector. Also, vertical integration is further developed which tightened the control over the production process in order to fulfill buyers' requirements in terms of standards. However, there remain quality issues at the processors stage. For instance, the weight of fish fillet is often increased by moisture retention agents (MRA), which drives down the quality and value of the fish. Processors mainly export low-value fish-fillet and have struggled to extend processing due to competition with buyers' processing facilities in importing countries. The sector also struggles to increase the share of waste processing (e.g. bone meal for livestock feed or fat for soaps). Though processors are represented by VASEP, the pangasius sector still lacks a unified industry voice and a joint visionary strategy due to high internal competition. This limits pro-active activities of the sector, e.g. in order to develop an international marketing strategy to counter negative publicity.

*Table 24: Top 5 pangasius exporters of Vietnam (2016)*

|                  | <b>Pangasius export turnover (USD)</b> | <b>%-share of total sea-food exports</b> | <b>%-share of total pangasius exports</b> |
|------------------|--|--|---|
| Vinh Hoan        | 251,199,251                            | 3.6                                      | 14.7                                      |
| Biendong Seafood | 133,977,654                            | 1.9                                      | 7.8                                       |
| Hung Vuong       | 102,241,016                            | 1.5                                      | 6.0                                       |
| Navico           | 80,168,746                             | 1.1                                      | 4.7                                       |
| I.D.I.           | 61,160,750                             | 0.9                                      | 3.6                                       |

Source: VASEP 2017a: 43

Besides challenges at the production and processing stage, the main current challenge for the pangasius sector, and for the vertically integrated processors in particular, are developments in export markets. While exports to the EU have already suffered from negative publicity (see below) access to the US market might be impeded in the future due to changes in import regulations. In September 2017, the responsibility for pangasius imports might be transferred from the US Food and Drug Administration (FDA) to the US Department for Agriculture (USDA). This would require equivalence between the Vietnamese pangasius regulatory system (esp. NAFIQAD) and Food Safety and Inspection Service (FSIS) regulatory system in order to continue exports to the US market. Interviewees in Vietnam<sup>21</sup> have criticized this shift, which is perceived to be in the interest of US catfish producers aiming to limit imports from Vietnam and thus decrease competition. Similar criticism has been voiced with regard to US anti-dumping measures. If the regulatory change were to become effective and Vietnam's regulation were not classified as being 'equivalent' to US regulation, pangasius exports to the US might be banned with large

<sup>21</sup> According to interviewees in the pangasius sector, it is unprecedented that a product that is already in circulation in the US is shifted from FDA to USDA regulation.

implications for the Vietnamese industry. There is furthermore the fear that other importing countries might follow the US lead, if pangasius imports to the US should be forbidden.

Enhancing the sustainability of the pangasius value chain has been a major concern for the industry and the government, and has been promoted by various programs. The government aims to address sustainability challenges through implementing nationwide international certification. An important program in this regard is the EU financed “Establishing a Sustainable Pangasius Supply Chain in Vietnam” (SUPA) implemented by the Vietnam Cleaner Production Centre (VNCPC) from 2013 to 2017. It strives to mainstream resource efficiency and cleaner production in the pangasius supply chain and to enable enterprises to reach ASC standards. Its overall objective is to promote a pangasius production, processing and exporting sector in Vietnam in accordance with long-term environmental, economic and social sustainability (SUPA 2017).

#### **4.4.4. Impact of the EVFTA on the aquaculture sector**

The seafood and aquaculture sector in Vietnam will be affected by the implementation of the EVFTA in various respects (i) due to changes in tariffs and RoO (the latter is only relevant for squid and octopus), (ii) the continuing importance of standards (SPS, TBT, etc.) that affect market access, as well as (iii) the provisions in the sustainability chapter and potential development cooperation linked to the EVFTA. The impact of the EVFTA on the sector will also depend on global value chain dynamics as well as local conditions and challenges of the respective seafood subsectors. Most importantly, to benefit from DFQF EU market access, export products particularly in food sectors must fulfill the EU’s strict quality and sustainability standards such as SPS, TBT and others, which has been a challenge for Vietnamese producers. Fulfilling these standards should be the focus of any sector strategy, and not just increasing the quantity of exports. Further, increasing the share of local processing and hence the export of value added products as well as taking into account social and ecological considerations is important from a development perspective. The latter also includes accepting certain limits in increasing seafood exports, when ecological boundaries are reached, such as in the case of overfishing of tuna, but also related to the expansion of farming systems for pangasius and particularly for shrimp production that may have problematic impacts on smallholders and the environment. The sustainability provisions as well as EU development cooperation could play an important role to support such a pro-development path of the sector.

In 2016, Vietnam exported USD 1.2 billion of seafood products to the EU, 49% of which were shrimp and 21% pangasius products (Table 25). These exports faced GSP tariffs in the EU market that reached from 4.2% to 8.5% for unprocessed shrimp, stood at 7% for processed shrimp as well as at 5.5% for unprocessed pangasius and at 7% for processed pangasius. The EVFTA will eliminate all EU tariffs on seafood products within 7 years after the agreement entered into force.

For shrimp, the EU market plays a key role (19% of total exports). The main shrimp export product accounting for 53% of shrimp exports is un-(or semi-)processed frozen shrimp (peeled or unpeeled) for which the GSP-tariff will be reduced from 4.2% to 0% immediately after the entry into force of the agreement (HS03). The tariff for processed shrimp (HS16), which makes up the other 47% of shrimp exports to the EU, will gradually be eliminated within 7 years after the entry into force of the agreement. The tariff-induced increase of exports of higher value added shrimp products will thus be delayed compared to un-(or semi-)processed shrimp products. The impressive growth rates of processed shrimp exports to the EU in recent years is nonetheless expected to continue – albeit maybe at a lower rate – given EU buyers’ demand for processing in producer countries. The EVFTA

may hence play a crucial role in assisting the goal of the government to significantly increase shrimp production until 2025, since Vietnam can enhance its competitive advantage vis-à-vis other main shrimp suppliers of the EU, such as India which faces GSP tariffs and Argentina which faces MFN tariffs. Other competitors, such as Ecuador and Bangladesh already have similar market access conditions under an FTA and the GSP/EBA regime with the EU, respectively.

Overall, stakeholders in the shrimp sector have expressed great optimism with regard to the tariff-induced export increases to the EU. The main challenges to use this potential are mainly related to limits to shrimp production capacity and to quality issues in the context of climatic changes and disease outbreaks. Besides, complying with the comparatively high requirements of buyers in terms of certification and labelling and copying with the associated costs will remain difficult.

For pangasius, the EU market has lost in importance in recent years in comparison to other markets, particularly China. In 2016, Vietnam exported USD 261 million of pangasius to the EU, compared to USD 581 million at its heights in 2008 (VASEP 2017a; VASEP 2012). In 2011, the EU was the largest market for pangasius exports with a market share of over 29%, however, the EU market lost in importance ever since (VASEP 2012). Only between 2015 and 2016, the share of pangasius exports to the EU decreased from 18% to 15% (VASEP 2017a; 2017b). Exports to the EU have suffered due to negative campaigning of European NGOs and the media regarding the sustainability of pangasius production, in particular in Spain, France, the Netherlands and Belgium (see Murk et al. 2016: table 1 for more details). This started in 2010 with the classification of Vietnamese pangasius with the label “Do not Buy” by the international NGO WWF. More recently, the French retailer Carrefour publicly denounced the sustainability of pangasius production due to its environmental impact in Vietnam and stopped sales of pangasius in January 2017. A study financed by the European Seafood Importers & Processors Alliance (SIPA) and conducted by researchers of the University of Wageningen nonetheless finds that “[...] *consumption of pangasius available on the European market does not pose any concern for the health of the consumers*” (Murk et al. 2016: 1).

The pangasius industry has not been able to counter this negative publicity at the European level, neither by arguing convincingly that the complaints are not correct nor by showing which steps have been taken to address these challenges. Clearly, this is a difficult task for a producer country, but there seems to be no industry-wide marketing strategy to address these complaints and to promote pangasius in the EU despite a business association (VASEP) with rather strong capabilities. Stakeholders in the pangasius sector have pointed out that pangasius processors and exporters are not sufficiently cooperative to develop joint international strategies for pangasius promotion due to their high internal competition. Instead of refocusing efforts on the EU market, exports of pangasius have shifted to China, which surpassed the EU as the second largest import market (after the US) of Vietnamese pangasius in 2016 (17.8% of total pangasius exports by value in 2016 compared to 10.3% in 2015) (VASEP 2017a: 40).

The tariff reduction of the EVFTA might however provide an opportunity for the Vietnamese pangasius sector to regain market share in the EU. However, the impact of the EVFTA will largely depend on changing the negative image of Vietnamese pangasius and hence on promoting pangasius products in the EU instead of shifting exports to other markets. Currently it seems that shifting export destinations is considered a suitable strategy to react to demand reduction in the EU market. However, the sustainability of this strategy will depend on the future development of demand in China and the outcome of the regulatory

change in the US. Further, the negative image in the EU market can also affect demand in other markets and particularly any upgrading strategies to higher value products.

In 2015, 97% of pangasius exports to the EU were low-value added products (HS03), mainly frozen fish filet, since EU buyers mostly import fish filet for further processing and branding in importing countries (Table 25). This share was reduced to 61% in 2016 due to a sharp drop in exports of low-value added products to the EU (-42% compared to 2015) and a sharp increase, albeit from a low level, of higher-value added exports to USD 35 million (HS16) (VASEP 2017a: 14). The 5.5% tariff on frozen fish filet will be eliminated within three years after the entry into force of the EVFTA. The 7% tariff on processed pangasius products will only be gradually eliminated within 7 years after the entry into force of the agreement. Stakeholders in the industry have communicated their concern about this delayed tariff reduction, since a quick reduction in price could have helped to sustain relationships with EU buyers in the current critical period. Overall, stakeholders in the industry do however hold high expectations with respect to the tariff reductions particularly for processed pangasius products. The tariff elimination might be sufficient for EU buyers to make the larger-scale import of higher-value added products more profitable.

*Table 25: Key seafood products exported to the EU and EVFTA tariffs*

|                      | 2016<br>(million USD) | GSP-tariff (%) | EVFTA-tariff (%) |
|----------------------|-----------------------|----------------|------------------|
| <b>Shrimp</b>        | <b>600.4</b>          |                |                  |
| <i>HS16</i>          | 284.3                 | 7              | B7               |
| <i>HS03</i>          | 316.0                 | 4.2 to 8.5     | A                |
| <b>Pangasius</b>     | <b>261.0</b>          |                |                  |
| <i>HS16</i>          | 35.3                  | 7              | B7               |
| <i>HS03</i>          | 159.6                 | 5.5            | B3               |
| <b>Tuna</b>          | <b>114.6</b>          |                |                  |
| <i>HS16</i>          | 53.0                  | 20.5           | TRQ              |
| <i>HS03</i>          | 61.6                  | 0 to 14.5      | B3               |
| <b>Total seafood</b> | <b>1,218.5</b>        |                |                  |

Notes: A = immediate liberalization; B3 = tariff liberalization within 3 years; B5 = tariff liberalization within 5 years; B7 = tariff liberalization within 7 years; TRQ = tariff rate quota, 11,500 tons; GSP- and EVFTA-tariffs represent key export products within the respective HS codes.

Source: VASEP 2017a; TARIC 2017; EC 2016

RoO were not changed in the EVFTA for the shrimp or pangasius sector and demand 'wholly obtained' status for HS03 and HS16 products. There are also no cumulation rules included which would affect the shrimp or pangasius sector. Vietnam can thus not import shrimp or pangasius for further processing without having to pay tariffs on exports to the EU market. More flexible RoO, in particular allowing for more generous cumulation rules,<sup>22</sup> would have been beneficial particularly in the case of the shrimp sector, since shrimp imports especially from India and ASEAN countries could in this case be used to balance shortcomings in the national production of shrimp. This is important as processors have certain capacities that need to be employed, which might be difficult in times where domestic production is low. Pangasius processors might have been able to diversify their

<sup>22</sup> The EVFTA allows for cumulation in the case of squid and octopus between Vietnam and ASEAN countries that have a preferential agreement with the EU (EC 2016, Chapter 4, Title 1, Article 3: 2).

product portfolio in case of more flexible cumulation rules (e.g. cumulation of pollack). Interviewees have been optimistic about the utilization of DFQF market access, notwithstanding the fact that traceability remains an issue with respect to RoO and certification. There exist for example reports that the EU doubts the origin of shrimp imports from Vietnam (Undercurrent News 2017).

Other barriers to trade that could limit the impact of the EVFTA, relate to SPS and TBT issues. However, the aquaculture industry seems to have learned the lesson from high rejection rates in the main export markets in the past (USA, EU and Japan) and has taken these issues seriously (cf. UNIDO 2013). The National Agro-Forestry-Fisheries Quality Assurance Department (NAFIQAD) is the government institution responsible for quality and safety in agricultural, forestry and fishery products. In the pangasius sector, vertical integration and contract farming has strengthened the control of processors over production and enhanced quality control mechanisms. Quality control in the shrimp sector is more complex, since production is more fragmented and extensive. Smallholders and intermediaries furthermore lack the capacity and capabilities for accurate quality control, putting the burden on processors. In this context, developments of rejection rates need to be carefully monitored in order to respond appropriately. Similarly, European buyers' demand for certification (e.g. ASC, GlobalGAP) to enhance the quality, traceability and sustainability of production along the value chain is also challenging for the aquaculture sector, and even more so in the comparatively fragmented shrimp value chain. A big issue in this regard is that different end markets demand different certifications, which adds costs and increases the need for training along the value chain. For example, EU buyers demand GlobalGAP, while Best Aquaculture Practices (BAP) is more frequently used in the US. Japanese buyers often do not demand certification but check residuals and visit production sites (UNIDO 2013).

The Trade and Sustainable Development Chapter of the EVFTA (Chapter 15) underlines the importance of responsible and sustainable management of living marine resources and aquaculture. The focus of the chapter is however on fish capture. The parties nonetheless highlight the environmental impact of aquaculture and commit to "Promote the development of sustainable aquaculture, taking into account its economic, social and environmental aspects" (EC 2016, Chapter 15, Article 8:d). The parties commit themselves to adhere to the principles of the FAO Code of Conduct for Responsible Fisheries of 1995, which provides a chapter regarding aquaculture development, and to exchange information on all new measures of management of fishery products that may impact on trade. This is very vague and hence its concrete effects remain unclear, but will arguably remain limited. This is unfortunate as the sustainability provisions in combination with EU development cooperation, could play an important role to ensure the sustainability of the sector and its contribution to broader development objectives.

#### **4.4.5. Conclusions and policy recommendations**

The strong growth of the shrimp and pangasius sectors in Vietnam are examples of successful integration in buyer-driven value chains in the context of stagnating marine fish capture and increasing aquaculture production on a global level. The sectors, despite many similarities, reveal also differences with regard to their structure, growth and upgrading potential, main challenges as well as potential impacts of the EVFTA.

The shrimp sector is by far the most important seafood export sector and continues to yield high growth potential. The sector is furthermore at the core of the National Action Plan of the General Department of Fishery, which ambitiously aims to more than triple exports by 2025. Though the fastest growing market for Vietnamese shrimp exports is China, the EU



is currently the second largest market of Vietnamese shrimp exports and thus plays an important role. The major challenges are increasing sustainable production as well as fulfilling the quality standards of international buyers. The EVFTA holds the potential to enhance the competitiveness of Vietnamese shrimp exports to the EU. For unprocessed products, which account already for less than 50% of exports, tariff reduction will become effective immediately, while for processed products only within 7 years after the coming into force of the agreement. The importance of processing companies in shrimp production is expected to grow. Smallholders will however continue to play a major role in shrimp production, given the importance of extensive farming systems where shrimp production is combined with other crops. Strategies to increase shrimp production should thus not only focus on processing companies, but also take into account the specific challenges of smallholders.

The future development of the pangasius sector also depends on being able to meet quality and sustainability standards, and particularly to improve its negative image in the EU market through strategic alliances at the industry-level and the development of a marketing strategy. If left unchanged, this negative image will potentially also impact other end markets, which have absorbed EU market shares in recent years. In China, future demand development is important and in the US the outcomes of regulatory changes will have potentially large negative effects on the Vietnamese pangasius sector. The EVFTA increases the competitiveness of pangasius exports for unprocessed products that account for the large majority of exports to the EU. For processed products the tariff reduction is higher which could provide an incentive to increase processing activities in Vietnam. It is, however, unclear if the tariff advantage together with low labor costs is sufficient for European buyers to relocate processing to Vietnam, given existing capacities in EU importing countries. Pangasius processors thus need to form strategic alliances in order to develop suitable market strategies in international markets as well as promote sustainable production to enhance such efforts and decrease the environmental impact of intensified pangasius production. This might be helped by the smaller role of smallholders, which if still operating, are often part of contract farming arrangements with processors.

Fulfilling quality and sustainability standards is key not only for having sustained access to international and particularly EU buyers, but also to ensure positive development effects in Vietnam. Hence, fulfilling these standards as well as increasing processing activities and the value of export products should be the focus of any sector strategy, and not merely increasing the quantity of exports. There seems to be still scope for expanding pangasius and even more so shrimp production in Vietnam, but there are also limits particularly with respect to intensification. Better waste water management will be crucial for both intensive and extensive farming systems as well as better seed provision and feed and drug use practices to ensure higher survival rates. Better cooperation at the smallholder farmers' level could play an important role in addressing joint challenges and be able to enter effective partnerships with processors on a more equal playing field.

The sustainability chapter could play an important role to address sustainability-related challenges in shrimp and pangasius production and export. But the very vague formulations make it doubtful how much action will effectively follow. The EU and the Vietnamese government would need to make the sustainability provisions operational through using them as a basis for developing support programs. Pressure by European and Vietnamese NGOs could play an important role in this regard. Evidently, programs to this effect would also require funding. Although not formally an integral element of the EVFTA, the future programming of EU development cooperation needs to take EVFTA related implementation challenges into consideration.



## 5. CONCLUSIONS AND POLICY RECOMMENDATIONS

In the concluding chapter, we summarize the detailed analysis and case studies for the EVFTA between the EU and Vietnam, in order to upon that basis draw comparative conclusions as well as key take away messages and policy recommendations. In the following, the chapter (i) provides a summary analysis of the key economic impacts, (ii) discusses opportunities and challenges of the FTA in the textile and apparel sectors as well as of productive development in export-oriented aquaculture value chains, and, finally, (iii) identifies the need for an effective implementation of the sustainability chapters by the EU. The last section concludes with key messages and take-aways.

### 5.1. Expected Economic Impacts

Vietnam has dynamically integrated into the world economy since the early 1990s and established a clear surplus in the merchandise trade balance of almost EUR 24 billion (see Section 2 for more details). While Vietnam enjoys already preferential market access to the EU via GSP and up to 24.5% of tariff lines are DFQF (equivalent to 59% of the EU import volume), the major export sectors, textile, apparel and footwear, benefit significantly from the reduction of tariffs by the EU and bilateral exports in these sectors contribute strongly to positive export effects. The liberalization of import tariffs by Vietnam increases the inflow of goods from the EU by more than 7%, with only a limited number of sectors (motor vehicles, machinery and foods) being affected by small negative real GDP effects (see section 4.1.3). For these individual sectors the impact may however be quite large which will require adjustment assistance to cushion negative effects, particularly given the importance of the food sector for the livelihood of farmers and consumers and the motor vehicles and machinery sectors for industrial development. In combination with consumption and multiplier effects, the positive impact on Vietnam's net exports to the EU leads to an increase in Vietnam's real GDP by 0.48% and a positive employment effect of 0.88% due to the trade impulses for in particular labor intensive sectors.

Overall, the liberalization initiated by the EVFTA is potentially beneficial for Vietnam as important export sectors (footwear, textiles and apparel) are granted full DFQF access to the EU market and, on the other hand, Vietnam faces only low import competition from EU products in most sectors. The EVFTA may further reduce dependence on Vietnam's main trading partner – the US. The effects on Vietnam's public budget deficit are rather small accounting for an increase 0.28% of GDP.

### 5.2. Implications of the EVFTA on export sectors in Vietnam

#### Improvements in market access in aquaculture-based value chains

In the Vietnamese aquaculture sector, the EVFTA enhances market access due to tariff liberalization for unprocessed as well as processed shrimp and pangasius products, albeit with different and longer liberalization schedules for higher value added products. GSP tariffs currently range from 4.2% to 8.5%. The aquaculture sector does not profit from relaxed RoO, e.g. regarding changes in product rules or cumulation possibilities.

#### Upgrading to higher value added products and processing is of strategic importance in agriculture based value chains

The improved market access brought-about by the EVFTA is likely to increase exports. In agriculture based value chains, of strategic importance is however to increase not only exports but to increase the share of higher value and processed export products. The

extent to which this will materialize will not only depend on market access but also on GVC dynamics and lead firm strategies as well as local opportunities and constraints for increased exports and upgrading.

The Vietnamese aquaculture sector is well-integrated in GVCs and supplies markets globally. In the case of shrimp, the potential for production increases exists, though production increases might have negative environmental impacts if not managed carefully. There are hardly any demand constraints for shrimp exports to the EU, thus the main challenge lies in product upgrading to higher value-added and in particular ready-to-eat products. The potential to increase the share of higher value-added products is comparatively high, since EU buyers' have limited capacities to process shrimp. The pangasius sector, on the other hand, struggles with increasing exports to the EU and currently expands exports mainly to Asia, in particular China. The main challenge lies in the strong competition with other low value-added fish as well as negative campaigning and – regardless of whether justified or not – increasing consumer awareness for social and environmental concerns in the EU. Functional upgrading to processing in the pangasius sector for exports to the EU is also more challenging since EU buyers have capacities for processing and hence are interested in processing fish-filet themselves. The pangasius sector furthermore lacks a clear strategy on how to tackle the image problem of Vietnamese pangasius in the EU due to high internal competition and thus low capacity of cooperation. Furthermore, the ability to fulfill the SPS and TBT standards of the EU is a challenge in both sectors.

### **Tariff reductions will benefit the apparel sector in Vietnam**

Regarding market access, the EVFTA will significantly enhance market access and thus increase the competitiveness of Vietnamese apparel exports to the EU. Vietnamese apparel exports to the EU are currently subject to GSP tariffs of between 8.5% and 9.4%, and the EVFTA will grant DFQF access over a transition period of eight years after the entry into force of the agreement. The GSP-RoO demand double transformation (fabric forward) for non-LDCs for apparel exports to the EU and the EVFTA will not bring any improvements in this respect for Vietnam. This implies that Vietnam will not be able to source fabrics from China and other important textile suppliers, but instead will have to rely on local or EU textile suppliers in order to export DFQF to the EU. The EVFTA, however, grants cumulation for Korean fabrics in the context of the EU-Korea-FTA.

### **Upgrading and expansion of the textile sector are of strategic importance to the apparel sector in Vietnam**

The main challenge for the Vietnamese apparel sector to benefit from the EVFTA and extended value added activities is the expansion of its textile sector as DFQF market access in the EVFTA demands double transformation RoO. Investments into the textile sector have grown in recent years, in particular in the context of the – now stalled – TPP negotiations. The EVFTA will also incentivize investments into the textile sector, however, not at a scale comparable to the TPP, which represents a much larger economic potential in this respect.

More generally, the apparel and textile industries in Vietnam should be considered a strategic export sector, to be used for learning and upgrading within the sector as well as beyond. Relying primarily on low-cost labor does not ensure sustained competitiveness. The country should thus increase its efforts to position itself as a more developed apparel supplier, extending its role from CMT production and lower value products to increasing local value added and linkages. Though some upgrading processes have taken place in

Vietnam's apparel sector, including process, product and functional upgrading, its extent has remained limited so far compared to other apparel producing country, e.g. Tunisia.

### **5.3. Trade and sustainable development**

The concept of sustainable development is usually defined as economic development that is socially inclusive and respects ecological boundaries. With the UN Sustainable Development Agenda, also a fourth, political dimension was introduced, which focusses on fostering peace, democracy and the rule of law, as well as cooperation amongst states and societies.

While our estimations have shown that small, but positive growth outcomes may well be expected for the case of Vietnam, this depends on the specific form of trade liberalization implemented. Only asymmetrical trade liberalization that safeguards in particular sensitive sectors and actively promotes social inclusion and environmental sustainability will make a positive contribution to growth. While consumer welfare might profit from lower prices for imported goods, of particular importance for developing economies is the balance between import competition and export revenues. Our assessment of export potentials has shown that Vietnam is in a comparatively good position, though proactive industrial policy measures are necessary to reinvigorate export growth.

Needless to say that growth alone is not sufficient. The extent to which growth is socially inclusive depends on a multitude of factors, both domestic and international. With the current trade agenda, the EU has focused on an approach that aims at promoting human rights and labor standards, and at an instrumental level privileges dialogue over hard conditionalities. As we have argued in the study, for this approach to become effective, it is, first, necessary to breathe life into the monitoring structures built into the agreements. Second, a more context-specific approach is advisable, which takes due account of the specific problems in a country and adapts both the substantive provisions and consultation process to local circumstances. Our analysis with respect to the T&A sector and aquaculture sectors in Vietnam has shown that particularly apparel and agricultural workers, who are also to a high degree women, represent vulnerable groups, whose rights need particular attention. A full realization of the potential of the sustainability chapter of the EVFTA thus will need a higher dose of ownership on the side of EU institutions, and much more support for cooperation between EU and partner country civil societies under EU development cooperation Aid for Trade programs.

In addition to dialogue, a second important aspect of social inclusiveness relates to the potential of trade agreements for promoting employment and decent work, i.e. employment that pays living wages and fosters good working conditions. Our analysis suggests that on balance the EVFTA will produce some employment gains depending on the liberalization scenarios, though not in all sectors of the economy. As trade liberalization typically has an impact on the structural production patterns in an economy, it is important to ease the social adjustment costs concomitant to that process. The latter is conditional upon the existence of basic social and employment policies in partner countries. In the case of developing countries, such policies often do not exist or lack from adequate funding.

Further, although export sectors may gain employment due to better market access, this quantitative impact says nothing about the qualitative aspects of the jobs created. The case study sectors are particularly prone to problematic working conditions in terms of low wages or prices, long working hours, problematic OHS standard compliance and restricted representation and collective bargaining. These labor issues are related to dynamics in

the GVCs, where competition is high and costs, quality, lead times and flexibility requirements of global buyers stringent. But they are also related to country specific contexts. Here it should be emphasized that Vietnam certainly does not dispose of a strong tradition in labor compliance measures. In both sectors, in addition to producer country regulations, private buyer-driven CSR initiatives are important. To have a sustained effect they need to be independently monitored and aligned with sourcing requirements of buyers. Further cooperation with local labor inspectorates and labor ministries as well as trade unions is of crucial importance, which could be developed in the context of the Sustainability Chapters of the EVFTA.

With regard to the environmental impact of trade liberalization, a systematic and comprehensive analysis has been beyond the scope of this study. Existing assessments on the EVFTA however suggest that on balance negative environmental effects in particular with respect to emissions will likely prevail, though this depends on a number of developments, in particular the sectoral specialization patterns, and is thus difficult to estimate for the long run (ECORYS 2009, 2013). With respect to the case studies covered in our report, we have argued that instead of an increase of unprocessed exports of shrimp and pangasius in the case of Vietnam, which clearly would have negative environmental repercussions, the challenge consists in extracting more value-added from the export-oriented production of these commodities. If managed properly, this would arguably also promote more sustainable production models, as consumers in Europe increasingly demand organically grown and sustainably harvested food products. EU development cooperation should support the ecological orientation of these value chains and facilitate branding and marketing activities for the establishment of high quality products in buyer-driven value chains, where lead firms are mostly residing in the EU. For the T&A sector, particularly water pollution related to the disposal of chemicals and washing water is a crucial concern. Particularly in the context of the development of a local textile sector, that is of strategic importance for the country, environmental issues have to be seriously addressed.

Finally, the political dimension of sustainable development is also important. In Vietnam, there is an ongoing political transformation where pro-economic reformers are struggling with China-oriented conservatives over the economic and political future of the country. Trade agreements play an important role in this broader transformation process, since they are used particularly by pro-reformers to support national liberalization agendas as well as by NGOs to push for labor rights particularly in the context of the Sustainability Chapter.

#### **5.4. Key take-away messages**

The **main findings and key policy recommendations** of the study can be summarized as follows:

##### **1. Estimated economic effects of trade liberalization for Vietnam are positive:**

Vietnam has dynamically integrated into the world economy since the early 1990s and established a clear surplus in its trade balance with the EU of almost EUR 24 billion in 2016. While Vietnam enjoys already preferential market access to the EU via GSP and up to 24.5% of tariff lines enter the EU market duty and quota free (DFQF) (equivalent to 59% of the EU import volume), the major export sectors, textile, apparel and footwear, will benefit significantly from the reduction of tariffs by the EU and bilateral exports in these sectors contribute strongly to positive export effects. The liberalization of import tariffs by Vietnam increases the inflow of goods from the EU by more than 7%, with only a limited number of sectors (motor vehicles, machinery and foods) being negatively affected with regard to

declining output. For these individual sectors the impact may however be quite large which will require adjustment assistance to cushion negative effects, particularly given the importance of the food sector for the livelihood of farmers and consumers and the motor vehicles and machinery sectors for industrial development. In combination with positive effects on domestic real consumption, the positive impact on Vietnam's net exports to the EU leads to an increase in Vietnam's real GDP by 0.48%. Due to the incidence of trade impulses for in particular labor intensive sectors, the EVFTA will have a higher effect on employment, with an increase of 0.88% or around 450.000 jobs.

## **2. Public revenue losses will negatively affect Vietnam, but should not pose a particular policy challenge:**

In the case of developing and emerging countries, the effects of tariff liberalization on the public budget need to be carefully considered, as typically tariff revenue is an important component of public income. In the case of Vietnam, our model simulation however show that forgone tariffs will be rather low, accounting for 0.28% of GDP, which is not expected to lead to substantial fiscal policy challenges.

## **3. Promotion of export sectors needs pro-active policies for upgrading:**

Given that trade liberalization should positively contribute to growth and employment creation, a careful consideration of the potentials for increasing exports in selected sectors is important. On the basis of a detailed analysis of specific agri- and aquaculture sectors (pangasius/shrimp) as well as the textiles & apparel sector in Vietnam, our analysis points to the need for policy interventions in two priority areas:

- a) *Export potentials for food products depend on investment in processing and branding activities and in quality infrastructure:* given that most GVCs for agricultural and food products are buyer-driven, increases in export revenues need an approach that aims at extracting more value-added from each unit exported. This is particularly the case, where further increases in export volume are constraint by production conditions, e.g. water scarcity, and/or lead to negative environmental externalities. Export-oriented upgrading activities, in particular processing of e.g. shrimp or fish into ready-to-eat products or production of bottled olive oil for final consumers, do not only need investment in processing facilities, but in particular marketing and branding strategies in order to gain access to retailers and become attractive to final consumers. Trade policy can support upgrading both by improving market access, e.g. by eliminating remaining tariffs and quotas, and furthermore, by supporting to meet standards, both public SPS and private standards of lead firm in GVCs, in particular quality standards and certifications for organic products.
- b) *Promotion of upgrading and of the textile sector is of strategic importance in the apparel sector:* against the background of continuing preference erosion in the apparel sector as more countries are receiving preferential market access due to the proliferation of FTAs, reduced lead-times and the trend to fast fashion, the sustained competitiveness of the apparel sector in the future will not primarily rest on the availability of cheap labor and DFQF market access, but on the availability of a flexible and high-quality production system that extends from the production of yarns and fabrics, the availability of accessories and finishing services to modern logistics and transport services. Apparel production in Vietnam should thus increase its efforts to position themselves as a more developed apparel supplier, extending their role from CMT production and lower value products to increasing local value-added and linkages. This will involve investments in the build-up of a domestic textile sector, but also extend to other supporting services,



e.g. increasing the availability of working capital for FOB production and productive investment credits as well as improving the technical skills of T&A workers.

#### **4. Trade policy should be policy-coherent for sustainable development and context-specific**

Sustainable development as defined by the UN Agenda 2030 and adopted by the European Consensus on Development, calls for the promotion of sustainable economic growth that is socially inclusive, respects ecological boundaries and promotes peace and democracy. Trade liberalization should thus be considered as a means to achieve the objective of sustainable development. Due to different geographical conditions, economic structures, political and institutional systems, trade liberalization outcomes for individual countries are however variegated, and it cannot be taken for granted that effects are exclusively beneficial, neither at the aggregate nor sectoral level. Thus, any approach to trade policy in compliance with the principle of policy coherence for sustainable development must take the specificities of a partner country systematically into account and adapt trade policy measures accordingly. The Sustainability Chapters are an important step forward in this regard but they need to be mainstreamed throughout the chapters of the core agreement. Further, where these chapters already exist such as in the case of the EU-Vietnam FTA, their formulation is rather weak and the political interest to implement them and fund the necessary dialogue processes has been weak on both sides.

In addition, Vietnam is currently on an important transition point with pro-economic reformers and China-oriented conservatives struggling about the economic and political future of the country. Trade agreements play an important role in this broader transformation process as they are used particularly by pro-reformers to support national liberalization agendas as well as by NGOs to push for labor rights particularly in the context of the Sustainability Chapter. Strong political will on the side of the EU is thus necessary to support the effective implementation of the Sustainability chapter of EVFTA.



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## APPENDIX

Table 1A: Sectoral Details EVFTA Model

|              | <b>Sector</b>      | <b>GTAP 9 Sectors (short)</b> |
|--------------|--------------------|-------------------------------|
| <b>1</b>     | Cereals (cer)      | PDR, WHT, GRO, PCR            |
| <b>2</b>     | VegFruit (v_f)     | V_F                           |
| <b>3</b>     | OthAgri (oag)      | OSD, C_B, PFD, CTL, OAP,RMK,  |
| <b>4</b>     | OthCrops (ocr)     | OCR                           |
| <b>5</b>     | Fishery (fsh)      | FSH                           |
| <b>6</b>     | Commodities (com)  | COA, OIL, GAS, OMN            |
| <b>7</b>     | Meat (mea)         | CMT, OMT                      |
| <b>8</b>     | Dairy (dai)        | MIL                           |
| <b>9</b>     | Foods (fds)        | VOL, ODF                      |
| <b>10</b>    | Beverage (b_t)     | B_T                           |
| <b>11</b>    | Textiles (tex)     | TEX                           |
| <b>12</b>    | Apparel (app)      | WAP                           |
| <b>13</b>    | Footwear (lsh)     | LEA                           |
| <b>14</b>    | Wood (wod)         | LUM                           |
| <b>15</b>    | Chemicals (che)    | CRP                           |
| <b>16</b>    | MotorVehicle (mvh) | MVH                           |
| <b>17</b>    | Machinery (mac)    | OME                           |
| <b>18</b>    | Electronics (ele)  | ELE                           |
| <b>19</b>    | OtherManu (oma)    | PPP, P_C, I_S, NFM, FMP, OTN, |
| <b>20 se</b> | Services (ser)     | All Service Sectors           |



### **List of conducted interviews**

Interviews were conducted in person or telephone and supplemented by inquires via email.

| <b>Institution/Organization/Business</b>  | <b>Date</b>    |
|---|----------------|
| Central Institute for Economic Management (CIEM)  | 27.03.2017     |
| Oxfam International   | 27.03.2017     |
| Friedrich-Ebert-Stiftung (FES)  | 27.03.2017     |
| Gesellschaft für Internationale Zusammenarbeit (GIZ)                                      | 27.03.2017     |
| United Nations Industrial Development Organization (UNIDO)                                | 27.03.2017     |
| Vietnam Fisheries Society (VINAFIS)   | 28.03.2017     |
| Vietnam Chamber of Commerce and Industry (VCCI)   | 28.03.2017     |
| Better Work – Vietnam Office  | 29.03.2017     |
| Vietnam Export Promotion Center (VIETRADE)  | 29.03.2017     |
| Vietnam Textile and Apparel Association (VITAS)   | 29.03.2017     |
| Vietnam Seaculture Association (VSA)  | 29.03.2017     |
| Center for Industrial Relations Development (CIRD)  | 29.03.2017     |
| International Labour Organization (ILO)   | 30.03.2017     |
| World Bank – Vietnam Office (WB)  | 30.03.2017     |
| Vietnam General Confederation of Labour (VGCL)  | 30.03.2017     |
| UNIDO – Vietnam Office  | 30.03.2017     |
| VITAS   | 30.03.2017     |
| Institute of Labour and Social Affairs (ILSA)   | 30.03.2017     |
| Vietnam Institute for Fisheries Economic and Planning (VIFEP)                             | 31.03.2017     |
| GIZ   | 31.03.2017     |
| CIEM  | 31.03.2017     |
| VGCL – fisheries  | 31.03.2017     |
| Center for Development and Integration (CDI)  | 31.03.2017     |
| Ministry of Industry and Trade  | 03.04.2017     |
| Food and Agriculture Organization of the United Nations (FAO)                             | 03.04.2017     |
| Vietnam Association of Seafood Exporters and Producers (VASEP)                            | 03.04.2017     |
| Action Aid  | 03.04.2017     |
| Vietnam Seaculture Association (VSA)  | 04.04.2017     |
| Establishing a sustainable Pangasius supply chain in Vietnam                              | 04.04.2017     |
| Delegation of the European Union to Vietnam   | 04.04.2017     |
| Vinh Hoan   | 06.04.2017     |
| Minh Phu  | 06.04.2017     |
| Various interviews with representatives of the T&A sector during the SAIGONTEX exhibition | 05.-07.04.2017 |