

COMMISSIONS SERVICES' ANNEX ON VIETNAM TO THE POSITION PAPER ON THE TRADE SUSTAINABILITY IMPACT ASSESSMENT OF THE FREE TRADE AGREEMENT BETWEEN THE EU AND ASEAN

1. INTRODUCTION

This paper is the Vietnam annex, to the position paper that was published by the Commission in June 2010 on the Trade Sustainability Impact Assessment (SIA) of the Free Trade Agreement (FTA) between the EU and ASEAN (hereafter, "the position paper").

Vietnam is an emerging country that over the last twenty years has experienced a high GDP growth rate, although in recent years it has not been saved from the effects of the global economic crisis. Since the introduction of the *Doi Moi* policy (the Renovation) in 1986, Vietnam aims at transforming the structure of its economy. From a purely centralized and state-controlled economy heavily dependent on agriculture, Vietnam aims to evolve into a socialist-oriented market economy structured towards a more balanced equilibrium between manufacturing and services. In 2010 the composition of GDP by sector showed an economic structure in which agriculture accounted for 20.6% of GDP, while industry and services accounted respectively for 41.1% and 38.3%¹.

Vietnam is an export-driven economy. Its key export items include footwear, textiles and clothing, coffee, rice, seafood, furniture, pharmaceutical products and iron and steel. The European Union is Vietnam's second largest trading partner (after China and on a par with the US). Vietnam is the fifth largest trading partner within ASEAN (and 35th out of EU's total trade). In 2011, EU-Vietnam trade in goods was worth over € 18 billion, with almost € 13 billion in exports from Vietnam to the EU, resulting in a € 7.6 billion trade surplus in Vietnam's advantage.

As set out in the position paper, when the SIA was commissioned, negotiations to conclude a region-to-region EU-ASEAN FTA had been envisaged. By the time the study was completed, these negotiations had been paused². Following this pause, the Council, gave the green light to initiate bilateral FTA negotiations with individual ASEAN countries³. These individual agreements should be seen as building blocks towards the ultimate objective of an agreement with ASEAN countries in the regional framework. The first set of negotiations started with Singapore in March 2010, followed by Malaysia in October 2010. on 26 June 2012, Commissioner De Gucht and the Vietnamese Minister for Industry and Trade, Vu Huy Hoang, launched negotiations for a bilateral free trade agreement between the EU and Vietnam.

As was done in the case of the Annexes for Singapore⁴ and Malaysia⁵, this Annex complements the Commission's services position paper by highlighting economic, social and environmental impacts identified in the SIA for a region-to-region FTA that are of particular importance with regard to Vietnam, together with the Commission's services views on those. The focus of this annex is the impact of an FTA with the EU on Vietnam. The potential impact for the EU was reflected in the position paper on the EU-ASEAN SIA.

¹ European Commission, 2012, In-depth datasheet on bilateral relations with Vietnam. [online] Available at: http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc_113463.pdf.

² Negotiations were paused in March 2009.

³ On 22nd December 2009 for Singapore, on 10th September 2010 for Malaysia

⁴ Published in June 2010 (http://trade.ec.europa.eu/doclib/docs/2010/july/tradoc_146295.pdf)

⁵ Published in January 2011 (http://trade.ec.europa.eu/doclib/docs/2011/january/tradoc_147337.pdf)

While the SIA deals with the impacts of the EU-ASEAN FTA, these findings remain valid and relevant in relation to the EU's ultimate goal of an agreement in the regional framework with ASEAN, despite the intermediate focus on bilateral agreements. The study contains, in addition, useful country specific elements for the bilateral negotiations. It provides country level detail, where relevant (specific issues and sectors) and gives an overall picture of the direction and magnitude of impacts, with a special focus on the impact of concluding a FTA with the EU on individual ASEAN countries. With the long term objectives unchanged, the longer term impacts should remain by and large the same.

The next section will present the main findings of the report concerning Vietnam. Section 3 will provide an overview of the policy recommendations of the SIA of particular importance in relation to Vietnam, and of the Commission's response on those recommendations.

2. OVERVIEW OF FINDINGS

i. ECONOMIC FINDINGS

According to the study, the overall welfare effects for the EU and all ASEAN countries are positive; and quite substantial in the case of some ASEAN countries. National income and GDP are expected to increase for both FTA parties.

Major benefits are expected to accrue for Vietnam. According to the SIA, Vietnam would stand to gain the most from an FTA of all ASEAN countries. Under the most ambitious scenario⁶, national income could rise by € 7.6 billion, GDP could increase by 15.27%, skilled real wages could increase by 12.61%, unskilled wages by 13.30% and the value of exports could increase by 34.86%.

The authors of the study also argue that Vietnam stands out particularly, with substantial shifts between sectors as the country realigns its economy as a consequence of further opening up and, accelerated structural transformation processes as the country moves towards becoming a market economy.

According to the SIA Vietnam stands to gain most in the footwear and leather sectors with the FTA unleashing its competitive potential and potential output. The footwear sector will benefit substantially from the reduction of customs duties applied by the EU following to the conclusion of the FTA. Moreover, the reduction of customs duties in bilateral trade will provide further incentives to the re-location of the production of footwear in Vietnam. This will further improve the export potential of the country. The FTA benefits for the leather sector in ASEAN will accrue mostly to Vietnam (besides Malaysia). Even though the sector is already a major source of employment in Vietnam, increases in employment in the sector are substantial. In the long run employment will increase slightly less than output, indicating that the sector will become more efficient and productivity will increase. On the other hand, prices are projected to decline as well, implying that output and exports – in the long run - will be concentrated in mass produced lower value added products.

The study also expects that benefits will accrue to the apparels sector in Vietnam: an initial decrease in outputs, employment and exports in the wearing apparel industry is expected to

⁶ The most ambitious scenario contains deep integration between the EU and ASEAN economies, showing the potential benefits of a far-reaching agreement: 1) 97% for goods, both for ASEAN and the EU (tariff lines and trade, including industrial, agriculture, fish and PAPs); 2) 75% liberalisation of services and; 3) 2% reduction of NTBs (custom and trade facilitation).

revers into a positive change in the longer run, as resources reallocate to the more competitive sectors. This can mainly be explained as a consequence of the structural change of the production basis in the economy towards higher value added products (especially in the more ambitious FTA scenarios).

In the cereal and grains sector, Vietnam will experience a negative impact from the FTA. According to the findings of the study the food industry will contract and prices will decrease. Vietnam can expect decreases in both output and employment. As Vietnam will further develop, the size of its cereal and grain sector will decline. This is mainly caused by an increasing demand for processed food from the EU (given the EU's comparative advantage in the sector). However, at a macro-economic level prices will go down and the production shift towards sectors with higher returns on inputs will make the country and the consumers better off. Exports will actually grow as production is exported to foreign markets, processed and imported back to Vietnam.

In the fishery sector output and employment will slightly decrease following introduction of the FTA. Prices, exports and imports show different trends. In the short run, Vietnam, one of the strongest fish exporters and producers, faces an immediate increase in its exports. In the long run a shift to higher value added products (processed food) is expected. The effects in the fisheries sector are thus strongly related to the effects in the processed food sector, as most of the fresh fish products go directly to the processing industry and are exported as processed products. This entails that – even though imports are expected to decrease strongly in the short run – imports will increase in the long run as the demands from the processing industry for fresh fish will increase. Due to this increasing demand for fresh fish, prices will increase in the long run as well – after an initial drop in the short run.

In other sectors the effects of an FTA will be negative, with major shifts between sectors as the spectacular growth in some areas - e.g. leather – will exert a pull on resources from all other sectors. For example the motor vehicles and parts sectors and insurance sectors all see a decline in output. The sectors in which Vietnam was a late arrival: electronic and machinery equipment will also see a downward trend as these sectors have not yet been able to build up the strength to withstand competition.

According to the SIA, Vietnam has a lot to gain from a FTA with the EU – even though some sectors might face some negative effects. Despite Vietnam's WTO commitments in services, there are still barriers that hamper trade in services compared to the situation in other developing countries. It is therefore expected that Vietnam could benefit from a preferential liberalization of some of its services sectors.

Furthermore, the SIA suggests that Vietnam will specialise in the financial sector rather than in the insurance sector. Indeed, the SIA predicts an increase in both exports and imports in the financial sector, whereas a clear decrease in exports and an increase in imports is expected for the insurance sector.

ii. SOCIAL FINDINGS

Poverty reduction depends strongly on the extent to which increased economic growth and trade trickle down to the wider population, particularly the poor. According to the study overall welfare effects for Vietnam are positive: in percentage growth of GDP terms, among ASEAN countries Vietnam is expected to benefit the most (along with Singapore).

However, at sector and regional levels impacts may vary, and gains are not always evenly spread. Thus the shift towards manufacturing sectors in Vietnam may initially lead to reduced real income levels in rural areas as people move towards the cities in search of higher paid jobs.

Structural transformation processes and the ongoing process of increasing global integration within the region results in substantial shifts within and between sectors, as competitive advantages crystallise into a more efficient resource allocation and international division of labour. Substantial shifts in employment patterns are predicted for Vietnam as major structural shifts take place in the labour market. In particular, the FTA may further fuel the ongoing structural change as labour from agricultural sectors moves to sectors with higher productivity levels.

The study suggests that this will particularly affect women in the Textiles, Clothing and Footwear (TCF) sectors where the workforce is predominantly female. As the footwear sector in Vietnam strengthens its competitive position it will start drawing employment and resources away from other sectors.

The authors argue that -given the high share of agricultural employment in Vietnam - the impact of the FTA may be quite significant. Lower prices and lower output will translate into lower real income for Vietnamese producers. By far the largest negative impact for output and employment are predicted to occur in the grain and cereals sector.

However, these negative real income effects arise only for those people directly employed in the agricultural sector. Consumers, on the other hand, will benefit from a cut in the price of cereals. The increased employment opportunities in the TCF sectors in Vietnam are expected to facilitate the structural transformation processes underway as agricultural workers can quite easily (i.e. without substantial retraining) be absorbed into these sectors, thus also contributing to poverty reduction.

The study also predicts that Vietnam will see an increase in output in the leather sector, together with a substantial increase in employment. The leather sector is a major source of employment for Vietnam. In the long run employment will increase slightly less than output, indicating that the sector will become more efficient and that productivity will increase. On the other hand, prices are projected to decline as well, with the implication that output and exports will be concentrated in mass produced lower value added products.

The fisheries sector is an important contributor to employment in Vietnam. As the sector is concentrated mostly in coastal and rural areas, it has a special significance particularly to the poorer parts of the society. According to the study, Vietnam will experience hardly any change at all in output and employment levels, or else very small negative impacts. Although the importance of the sector in Vietnam implies that the percentage changes could have larger real effects.

In both the financial services sector and the insurance sector a decrease in employment is foreseen for Vietnam. According to the SIA, the largest percentage decline in employment takes place in the insurance sector. These seemingly large changes can be mostly explained by labour being pulled out of the sector to be allocated to more competitive sectors. Another explanatory variable is the small size of the sector (both in terms of output and employment).

iii. ENVIRONMENTAL FINDINGS

The effects of increased ASEAN-EU trade on environment are difficult to quantify and the SIA does not attempt to break down the effects per country. The general effects as detailed in the main position paper under section 3 can be expected to apply equally to Vietnam. However, some points pertinent to Vietnam can be noted.

As regard fisheries, environmental issues, including biodiversity, are important and possible negative impacts could be encountered in this sector as catches and by-catches increase. This may result in overfishing. According to the study this risk applies less to Vietnam than to other ASEAN countries, because a large proportion of Vietnam's fish production comes from aquaculture (which nevertheless has its own land-use and biodiversity issues). The aquaculture subsector is particularly important in Vietnam and its rapid increase has led to environmental concerns. However, European consumers, many larger retailers and processing companies nowadays demand sustainability assurances for the products they buy. The authors of the study therefore state that, although it can be argued that the current environmental problems may be worsened as a result of increasing production, stricter government regulation and pressure from EU following implementation of the FTA could also lead to improved environmental practices and protection, and thus to a more sustainable fishing industry.

The study also argues that the expected, rapid expansion in the leather sector could bring negative effects on the environment as it is a heavily polluting industry.

Vietnam is a key player in the timber sector in South East Asia. Being primarily a processing country, Vietnam imports its timber from a large number of countries in the region, including Laos, Thailand, Cambodia, Malaysia and China. Another environmental issue is relevant for Vietnam is therefore illegal logging and trade in illegal timber, as Vietnam is a processing and transshipment country.

3. RECOMMENDATIONS AND THE COMMISSION SERVICES' VIEWS

The recommendations of the SIA apply to all the ASEAN countries and as such, most of the conclusions in the chapter on recommendations (section 5) can be applied to Vietnam. The Commission services' views on these recommendations have been reflected in the position paper. This section of the Vietnam Annex highlights SIA recommendations of particular relevance to the country and outlines the Commission's response to those recommendations.

i) FTA MEASURES

Three recommendations of the SIA are particularly pertinent to Vietnam. Firstly, the SIA recommends that - despite the overall long-run economic benefits of a FTA - any negative economic, social and/or environmental impacts and adjustment challenges should be, inter alia, addressed by the phasing-in of tariff liberalisation rather than an immediate and complete tariff reduction across all sectors.

Since the opening up of Vietnam's economy will lead to major structural changes and initial unemployment, the recommendation to phase in tariff reductions gradually is relevant. The gradual adjustment will allow the necessary policy and legislative reform to be passed, as well as for improvements in competitiveness. Secondly, further improvement in the business and investment climate will be necessary as Vietnam ranks quite low in ASEAN in terms of ease of doing business.

Furthermore, the inclusion of a sustainable development chapter with specific social and environmental provisions is also one of the main overall policy recommendations. The importance of creating an adequate monitoring and evaluation system on sustainable development issues is also highlighted.

Vietnam has signed up to five out of eight core ILO conventions and has ratified major environmental conventions. Measures to promote high levels of labour and environmental standards and a renewed emphasis on compliance will be important.

In Vietnam, the effective participation of civil society, including social partners and the private sector, in trade and policy making processes may be a particular challenge.

Response:

- Regarding a phasing-in of tariff liberalisation, Commission services recognise the merit of a degree of asymmetry in tariff liberalisation in those sectors that will need time to adjust.
- The Commission recognises the importance of a comprehensive and ambitious chapter on trade and sustainable development, aimed at bringing about economic prosperity through and with a high level of environmental protection and social equity and cohesion. The reflection of internationally agreed principles, rules and standards, the promotion of high levels of social and environmental protection, and the commitment to uphold those levels of protection through the effective enforcement of relevant domestic laws are important elements to be discussed in the sustainable development chapter.
- The Commission aims at establishing a mechanism based on transparency, dialogue and cooperation in order to oversee and follow up on provisions in the sustainable development chapter.
- The Commission also recognises the importance of dialogue with civil society, including with social partners, with a view to enabling civil society to take a strong role in overseeing and assessing the FTA as recommended by the consultants.

ii) ECONOMIC MEASURES

While Vietnam is expected to benefit economically overall, the SIA predicts that the FTA will trigger or reinforce structural adjustment processes, which at least in the short run, might cause some negative effects. Economic policies can help minimise such negative externalities as well as help spin-off long term sustained economic growth. The SIA also states that - under the FTA - the business and investment climate in Vietnam will need to be improved. Several issues need attention, for example state controls over prices and enterprises for certain commodities and restrictions on imports. Improving the investment climate and ensuring that state owned enterprises operate their businesses in line with commercial/competitive behaviour, subject to the competition law scrutiny, can create many new opportunities for SMEs and spur innovation and investment. Addressing competition policy issues will therefore stimulate entrepreneurship and competitiveness of the SME sector.

Response:

- The Commission acknowledges the importance of supporting the transitions from short to long run, and accelerate the adjustment process.
- Vietnam benefits from EU Trade Related Assistance programmes at regional level through ASEAN regional programmes; as well as from support in sectors relevant to trade

at national level. In particular the EU will be providing support to Vietnam to enhance its Free Trade Agreement negotiation capacity in the framework of the European Trade Policy and Investment Support Project (MUTRAP).

- Vietnam has put in place a comprehensive competition law that includes the creation of a Competition Commission and Competition Council. However, even though competition authorities have been established it is difficult to keep them operational due to constraints in budgetary and human resources. In addition, the government has introduced a new foreign investment regulation in order to encourage the inflow of foreign direct investment. Implementation and enforcement are now key in ensuring the effectiveness of this initiative. In the framework of MUTRAP the Commission can support the process for implementation and application of competition laws in compliance with international commitments.
- In the field of competition, the Commission continues to strengthen ASEAN Member States' understanding and knowledge in setting up effective competition policies. To support the effective establishment and application of competition rules the Commission is willing to offer technical assistance subject to the availability of funding for such activities under the Parties' cooperation instruments and programmes.

iii) SOCIAL MEASURES

Under the long term scenario, the SIA predicts a major shift in Vietnam's economy to the clothing industry with mass produced lower value added products and to the leather industry. With a large workforce, including a large proportion of female workers, efforts will be needed to ensure adequate labour protection standards and to avoid undercutting competitors by bypassing workers' rights.

Response:

- For the Commission services, the recognition that social laws and standards should not be weakened in order to encourage trade and investment is also an important element in addressing concerns on the "race to the bottom".
- In the framework of the trade and sustainable development chapter, the Commission pays specific attention to core ILO labour standards, and to the principles inherent in them, to other ILO conventions, as well as to the promotion and realisation of the decent work agenda through domestic laws and practices
- Besides the sustainable development chapter in the FTA, cooperation following implementation of the FTA remains essential, in particular in areas such as promoting the Decent Work Agenda, labour relations and social dialogue. In this sense, the Commission services aim at making progress through dialogue and cooperation to make our economic and trade-related endeavours sustainable in the long term.

iv) ENVIRONMENTAL MEASURES

The SIA identified moderate effects of the FTA on environmental sustainability in ASEAN; although many of the impacts identified are existing issues related to the generally vulnerable environmental situation in ASEAN and pressures stemming from population and economic growth trends and resource depletion. Considering the on-going nature of these pressures on natural resources in ASEAN due to a variety of factors, it is hard to attribute these impacts

directly to the FTA, but the FTA could nevertheless exacerbate on-going trends. At the same time, it could be used to help solve certain environmental problems, thus contributing in a positive way.

The authors of the SIA argue that a tightening on environmentally damaging activities in various sectors could help to reduce negative environmental impacts. Many textile factories for example are currently causing environmental damage through discharge of toxic wastewater from dyeing and bleaching; and there is a clear risk that chemicals used in the processes of textile and leather treatment will be released into the environment. These issues may be improved by stricter government regulation and by pressure from EU importers as well as and EU consumer demands following introduction of the FTA, leading to greater overall environmental quality.

With respect to the forest sector, the SIA recommends that FTA negotiations should take into account the possibility of building a link to the on-going Forest Law Enforcement, Governance and Trade (FLEGT) negotiations. According to the study, additional leverage in favour of signing a Voluntary Partnership Agreement (VPA) may be achieved by examining the remaining tariffs on timber products. The SIA recommended in this regard the investigation of: 1) the possibility of granting tariff reductions for timber and timber-products made of verified legal timber such as that derived from FLEGT VPA, and 2) the inclusion of FLEGT and - where applicable the use of VPA or other mechanisms for checking legality - in the sustainable development chapter of the FTA.

Response:

- In the framework of the chapter on trade and sustainable development of the FTA, the Commission recognises the importance of reflecting adherence to multilateral environmental agreements, promoting trade and investment in, inter alia, environmental goods and services and innovative and cleaner technologies, and supporting the sustainable management of natural resources, such as forestry and fisheries (e.g. in the framework of international Instruments on Management and Conservation, cooperation in Regional fisheries organisations and fight against Illegal, Unreported and Unregulated (IUU) fishing), including through the promotion of trade in legally obtained and sustainable products.
- Also, the EU is conducting the negotiation of an EU Voluntary Partnership Agreement (FLEGT/VPA) agreement with Vietnam. The VPA will include commitments and action from both parties to halt trade in illegal timber, notably with a scheme to verify the legality of timber exported to the EU. The agreement also promotes better enforcement of forest law and promotes an inclusive approach involving civil society and the private sector. In the area of environment Vietnam has ratified major conventions. Measures to promote high levels of environmental standards and a renewed emphasis on effective implementation efforts as well as, where relevant, ratification – will be important.

4. CONCLUSION

The study shows that Vietnam can expect economic gains under an FTA with the EU. Moreover, the FTA can also provide momentum to regulatory initiatives.

Vietnam can expect large scale gains under an FTA. However, the FTA will stimulate a great structural shift in Vietnam's economy as it opens up to international trade. This may incur

short term adjustment and necessary social protection mechanisms will need to be in place to make the transition as smooth as possible.

The SIA also highlights the intertwined nature of the impacts in the economic, social, and environmental spheres. The Commission considers a comprehensive and ambitious chapter on trade and sustainable development as an essential element of the FTA, providing for mutually supportive social development, environmental protection, and economic growth. Therefore Commission services will continue to advocate an ambitious agenda regarding sustainable development, as one of the EU's overarching policy objectives.

In this framework, key issues are the effective application of core labour standards and the promotion of and adherence to sustainable development principles in environmentally sensitive areas, such as trade in timber products and fisheries.