VIETNAM'S TRADE WITH JAPAN

LONGER-TERM PROSPECTS FOR THE VIETNAMESE AGRICULTURAL SECTOR

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INTRODUCTION AND BACKGROUND

Over the past decade, Japan has been Vietnam's most important trading partner, its largest donor, and a primary source of investment. Although surpassed by the United States in 2003 as Vietnam's largest trade partner and export market, Japan remains an important destination for Vietnamese exports and a critical source of inputs for modernizing its economy. This relationship plays a particularly important role in Vietnam's agricultural sector, which accounts for 22 percent of Vietnam's GDP and employs 60 percent of its population (World Bank, 2005). Agricultural exports comprise nearly a quarter of Vietnam's total exports to Japan, and maintaining and expanding these exports will be a key component of sustaining economic growth and reducing poverty in Vietnam.

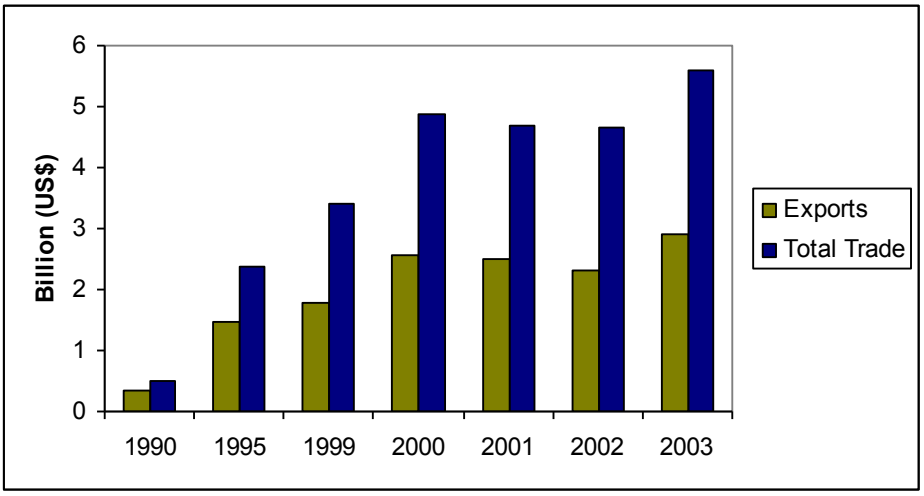
Vietnam's trade relations with Japan are developing against a backdrop of dramatic change in East Asian regional trade. Japan has been a net agricultural importer since the mid-1980s, but became a primary export market for East Asian agricultural exporters in the mid-1990s. The rapid rise of efficient Asian agricultural producers, such as China and Thailand, will spell greater quality and price competition for Vietnamese farmers and businesses in Japanese markets. In addition, Japanese sanitary and phytosanitary regulations for agricultural product imports have grown more stringent over the past five years. A strong collaboration among Vietnamese policymakers, farmers, businesses, and scientists will have to improve the country's agricultural system to respond to increasing competition and meet higher standards for agricultural exports.

While growing competition and rising standards present challenges for Vietnam, opportunities are equally abundant. A rebound in economic growth, domestic agricultural reforms, and a growing dependency on agricultural imports in Japan could provide greater access for Vietnamese agricultural goods. Additionally, Japan's role as a major donor, source of investment and inputs, and export market provides potential advantages for Vietnam in Japanese markets. To exploit these opportunities, however, Vietnamese policymakers and businesses must couple domestic improvements with a more active and effective system for promoting international trade.

Vietnam-Japan Trade Relations in a Changing Context

Vietnam and Japan established formal diplomatic and trade relations in 1973, but bilateral trade volumes between the two countries did not begin to grow substantially until the early 1990s following the collapse of the Soviet-led Council for Mutual Economic Assistance (COMECON). From 1990 to 2000 two-way trade grew by 857 percent, from US$509 million to US$4.8 billion (ADB, 2004). By 1995 Japan was Vietnam's largest trading partner and its primary export market. Despite a brief downturn in 2001 and 2002 as a result of the Asian Financial Crisis, both Vietnam's exports to Japan and overall trade levels have witnessed steady growth since 1990 *(see Figure 1)*.

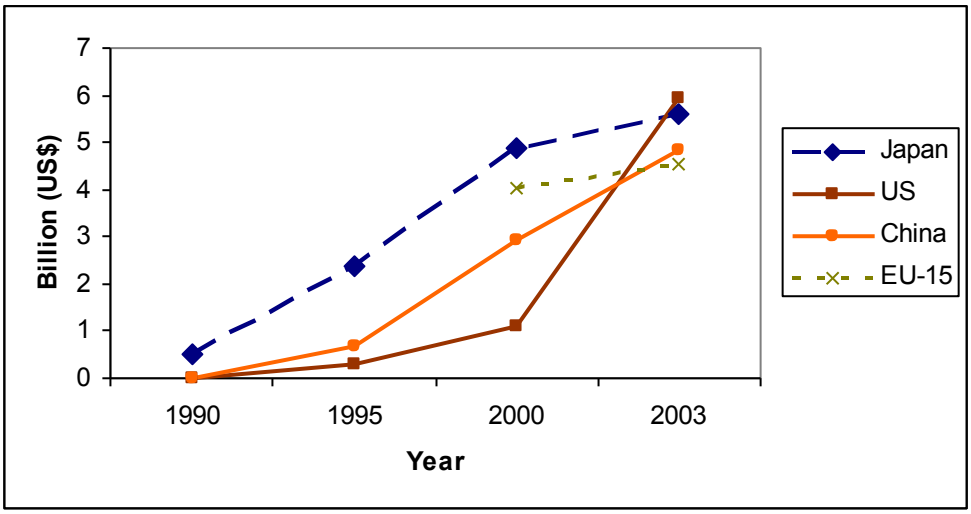
Figure 1: Vietnam's Exports to and Total Trade with Japan, 1990-2003



Source: ADB (2004b).

Although Vietnam's greater integration into the global and regional economy has diminished Japan's relative importance to the Vietnamese economy *(see Figure 2)*, Vietnam's growing interdependence with the U.S., European, and Chinese markets has elevated Japan's significance as a strategic balancing factor among major powers. China's growing influence in particular, both as an exporter and as a consumer, has dramatically changed East Asia's economic architecture — China became Vietnam's third-largest and Japan's largest trading partner in 2003. Strategic considerations about Vietnam-Japan trade relations will be formulated within this new context.

Figure 2: Vietnam's Major Trading Partners, 1990-2003



Source: Data for Japan, US, and China are from ADB (2004b); data from EU-15 are from Eurostat website, europa.eu.int/comm/eurostat (May 2005).

Japan is unique among Vietnam's primary Asian trade partners as the only major Asian country with which Vietnam has historically had a trade surplus.[1] A significant component of this surplus can be attributed to the continued growth in Vietnamese agricultural exports to Japan. As agricultural export competition among East Asian countries intensifies for other East Asian markets, Vietnam will have to modernize its agricultural regime to expand — and indeed to maintain — its current market shares. China and Thailand, in particular, have begun to

[1] This surplus edged toward parity in 2003 and 2004. In 2003, Vietnam ran a US$77.9 million trade deficit with Japan; in 2004 it had a trade surplus of US$7.3 million (ADB, 2005).

capture increasing market share in East Asian agricultural markets and have emerged as formidable competitors for Vietnam (RFIV, 2004).

Trade and Economic Cooperation

Improved Vietnam-Japan trade relations have been accompanied with more limited efforts to increase institutionalized cooperation. Vietnam and Japan exchanged most favored nation (MFN) status in May 1999. In April 2003, the two countries signed the Vietnam-Japan Joint Initiative, which laid out a strategy to improve the environment for foreign direct investment (FDI) in Vietnam by strengthening its institutional and infrastructural capacities. In an attempt to explicitly increase Japanese investment in Vietnam, the Vietnam-Japan Investment Protection Agreement, signed in November 2003, guarantees investors of either country national treatment in their investments in the other country.

In mid-2005 Vietnam and Japan completed bilateral negotiations on Vietnam's accession to the WTO. However, deeper trade and investment integration between Vietnam and Japan will likely take place within an ASEAN (Association of Southeast Asian Nations) framework. In December 2003 Japan committed to establishing a free trade area (FTA) with the six founding members of ASEAN by 2012, and with its four newer members by 2017.[2] However, agriculture continues to be a major obstacle occluding trade agreements between Japan and its more agriculturally-oriented Asian neighbors. Japan's interest in a Japan-ASEAN FTA stems in large measure from fears of losing further influence in the region to China, which began the Early Harvest Period (EHP) of an FTA with most ASEAN members in early 2004. Japan's openness to agricultural trade reform will be ultimately determined by who holds the final say within the Japanese government — the reform-minded Ministry of Economy, Trade, and Industry (METI) or the

[2] The six founding countries include Brunei, Indonesia, Malaysia, the Philippines, Singapore, and Thailand; the four newer members are Cambodia, Laos, Myanmar, and Vietnam. Japan has a formal trade agreement with Singapore and is currently negotiating bilateral agreements with Indonesia, Malaysia, and Thailand.

more conservative Ministry of Foreign Affairs (MOFA), backed by the Ministry of Agriculture, Forestry and Fisheries (MAFF) (Sato, 2004).

Japan is by significant measure the largest source of overseas development aid (ODA) to Vietnam, accounting for 26.5 percent of total ODA to Vietnam in 2004.[3] Much of this aid — and mostly in the form of loans — has been disbursed through regional and multilateral institutions. In particular, Japan has been an active donor to Vietnam through the Asian Development Bank's (ADB's) Japan Fund for Poverty Reduction (JFPR) and the Greater Mekong Sub-region (GMS) program and the World Bank's Japan Social Development Fund (JSDF). In both its development assistance to and investment agreements with Vietnam, the Japanese government has given explicit priority to supporting, *inter alia*, rural and agricultural development in Vietnam (GoJ, 2004; MOFA, 2004). Japan's role in Vietnam's agricultural sector is thus polymorphic and multidirectional, supplying aid, technical assistance, private investment, and agricultural inputs, as well as an export market.

The Japanese Market for Agricultural Products[4]

Japan is the world's third largest importer and the world's largest net importer of agricultural products, with imports totaling US$58 billion in 2003.[5] Japan imports about 60 percent of its food each year,[6] and Japanese consumers have become dependent on a wide variety of imported goods. At US$13.6 billion in 2002, accounting for 22 percent of world import value in that year, Japan is the world's largest importer of fish and fish products (FAO, 2004). Japan is also the world's largest meat importer, and since the mid-1980s, has also evolved into a major importer of fruits and vegetables. For Vietnam, and for other Asian agricultural

[3] Embassy of Japan in Vietnam website, online at: www.vn.emb-japan.go.jp (May 2005).
[4] The term 'agricultural products' is given a broad connotation here to include both agricultural and forestry products.
[5] "Leading exporters and importers of agricultural products, 2003," WTO Website, online at: www.wto.org (May 2005).
[6] "Briefing Room: South Korea," United States Department of Agriculture Economic Research Service website, online at: www.ers.usda.gov/Briefing/Japan/ (May 2005).

exporters, Japan is a primary market for agricultural products. Vietnam's agricultural product exports to Japan reached more than US$1.02 billion in 2004, over 25 percent of total exports to Japan.[7]

Despite high import levels, the Japanese market for agricultural goods remains relatively difficult to access because of government subsidies and strict quality controls on imports. Japan maintains "extreme" price support measures for specific commodities, and rice in particular; Japan's average agricultural support was US$9,709 per hectare in 2002, comprising 59 percent of the total value of its domestic agricultural production (USTR, 2003).[8] Japan also uses tariff-rate quotas (TRQs) to product its most sensitive agricultural products, chiefly cereals and dairy products. In World Trade Organization (WTO)-related agricultural negotiations Japan has typically sided with the "non-trade concern group" (also including Switzerland, Norway, and South Korea), calling for a more gradual schedule for reducing agricultural tariffs. This stance led, in part, to the collapse of trade talks at the Fifth WTO Ministerial Conference in Cancún in September 2003, as Japan rejected the U.S.'s and EU's draft statement that called for a ceiling for agricultural tariffs.

A series of food accidents and scandals in Japan over the last five years has elevated food safety to a key political issue, leading to the passage of a revised Food Sanitation Law and a new Food Safety Basic Law in 2003. Agricultural imports are similarly being held to higher standards through more stringent sanitary and phytosanitary regulations. Additionally, as food safety is increasingly reflected in price premiums some Japanese supermarket chains are adapting higher standards than those required by government regulation. The net effects on Japan's agricultural import levels may be mixed, as the introduction of more stringent standards was coupled with simplified procedures for imports (Jonker et al., 2004). In addition, Japanese buyers tend to conduct lengthy due diligence

[7] Japanese customs statistics, online at: http://www.customs.go.jp (May 2005).
[8] By way of comparison, per hectare agriculture support in the EU and US was US$676 and US$117, respectively, in 2002 (USTR, 2003).

before choosing suppliers, and companies reject imports or change suppliers infrequently (Joker et al., 2004). Nevertheless, Vietnamese producers have at times fallen short of Japan's standards for agricultural imports; Vietnamese dragon fruit was summarily banned from the Japanese market in the late 1990s after fruit fly eggs were discovered in dragon fruit imported from Vietnam.

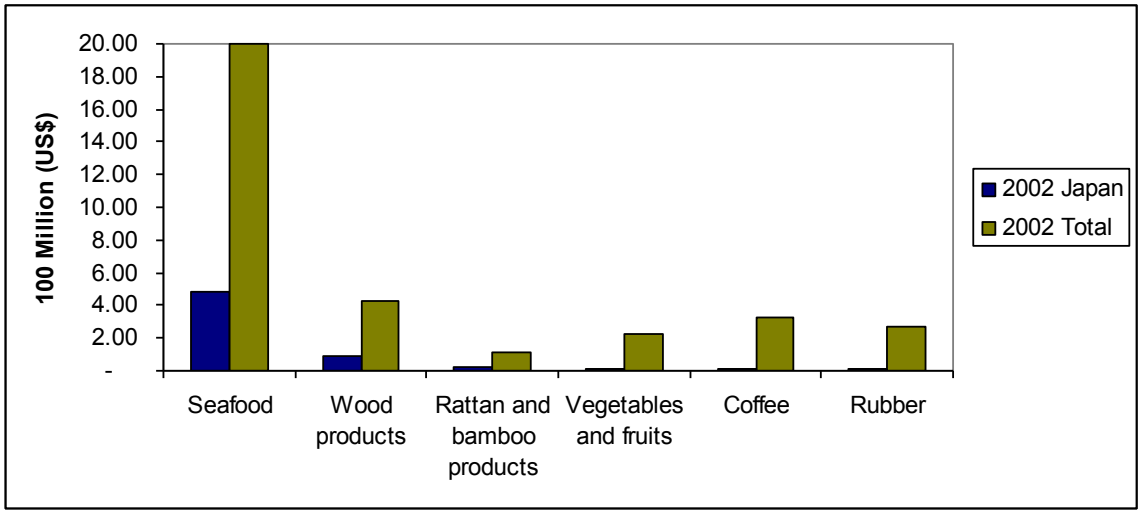
Japan is currently amidst two divergent trends: while the country continues to strive for self-sufficiency in food production, its farm sector is both contracting and aging. Concerned about its growing dependence on food imports — Japan's agricultural product imports are increasingly outpacing GDP growth — the Japanese government set a food self-sufficiency ratio of 45 percent by 2010. At the same time, however, Japan's agricultural sector is shrinking and aging. Over the past 40 years, the number of farmers in Japan has dropped by nearly one-fourth and the average age of remaining farmers is more than 60; 80 percent of farmers are over 50.[9] The latter trend will likely triumph, with Japan's agricultural production continuing to decline and the country becoming more dependent on foreign imports. Like its farmers, Japanese society as a whole is growing old, and Vietnam's longer-term gains from agricultural exports to Japan will likely come through Japan's greater dependency on imports rather than through its increasing consumption.

[9] "Agri-food Country Profile: Japan," Agriculture and Agri-food Website, February 2003, online at: http://atn-riae.agr.ca/asia/e2982.htm (May 2005).

TRADE IN SPECIFIC AGRICULTURAL PRODUCTS, VIETNAM AND JAPAN

Seafood has historically been Vietnam's most important agricultural export item to Japan, accounting for more than 20 percent of total exports — and 79 percent of agricultural exports — in 2004.[10] Wood products, rattan and bamboo products, fruits and vegetables, coffee, and rubber are other key agricultural exports *(see Figure 3)*. On the import side, Japan has been a major source of inputs for Vietnam's agricultural sector.

Figure 3: Vietnam's Major Agricultural Exports by Destination, 2002



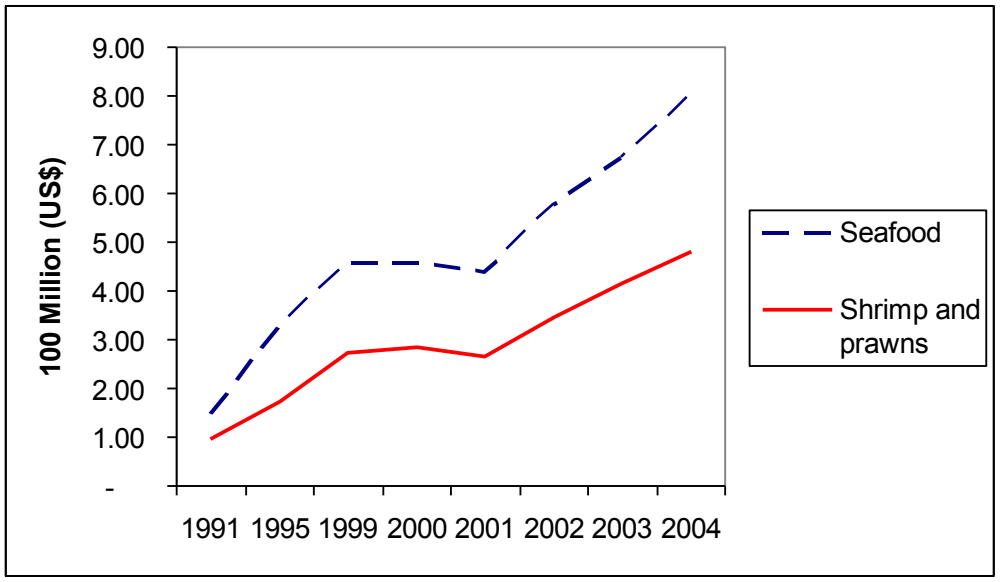
Source: Seafood data are from VASEP website, online at: http://www.vasep.com.vn (May 2005); other data are from GSO (2004).

Japan and the U.S. are Vietnam's primary markets for seafood exports. Japan accounted for 32 percent of Vietnam's total seafood exports in 2004.[11] While exports to the U.S. have fluctuated in the face of regulatory issues, Vietnam's seafood exports to Japan have seen steady growth, particularly from 2001 to 2004 following the Asian Financial Crisis *(see Figure 4)*. Roughly 60 percent of

[10] Japanese customs statistics, online at: http://www.customs.go.jp (May 2005).
[11] "Export/Import Product Information", online at: www.customs.gov.vn (May 2005) [Vietnamese].

Vietnam's seafood exports to Japan consist of shrimp and prawn; Vietnam surpassed Indonesia as Japan's largest exporter of unprocessed shrimp in 2004.[12]

Figure 4: Vietnamese Seafood and Shrimp Exports to Japan, 1991-2004

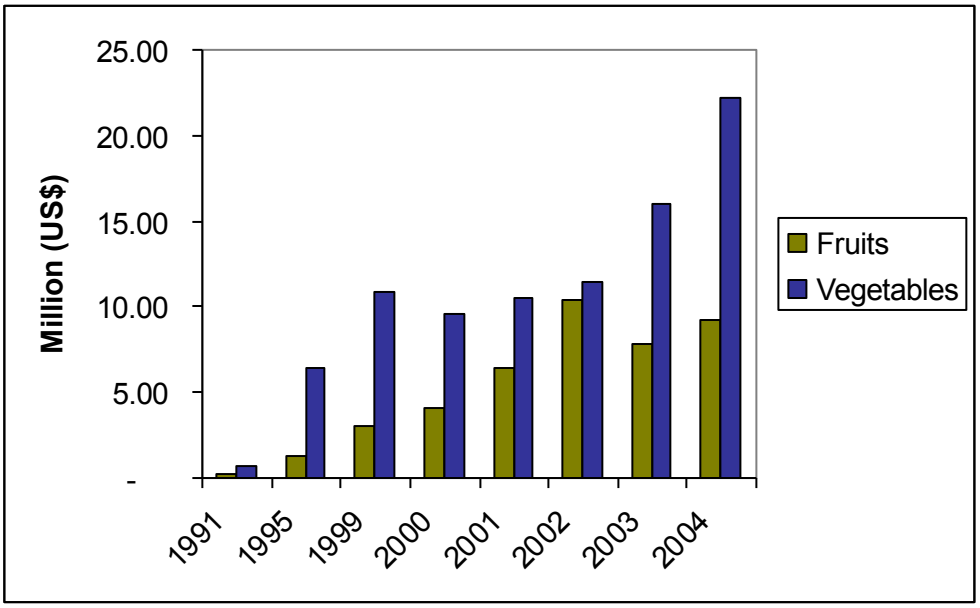


Source: Japanese customs statistics, online at: http://www.customs.go.jp (May 2005).

For Vietnam's fisheries industry as a whole, value added competition from China will bring new market pressures. China, rapidly developing capacity as a value-added processor of fish products, overtook Thailand in 2002 as the world's largest exporter of fish and fish products (FAO, 2004). Indonesia, India, and Australia are also major seafood exporters to Japan.

[12] Japanese customs statistics, online at: http://www.customs.go.jp (May 2005).

Figure 5: Vietnamese Fruit and Vegetable Exports to Japan, 1991-2004



Source: Japanese customs statistics, online at: http://www.customs.go.jp (May 2005).

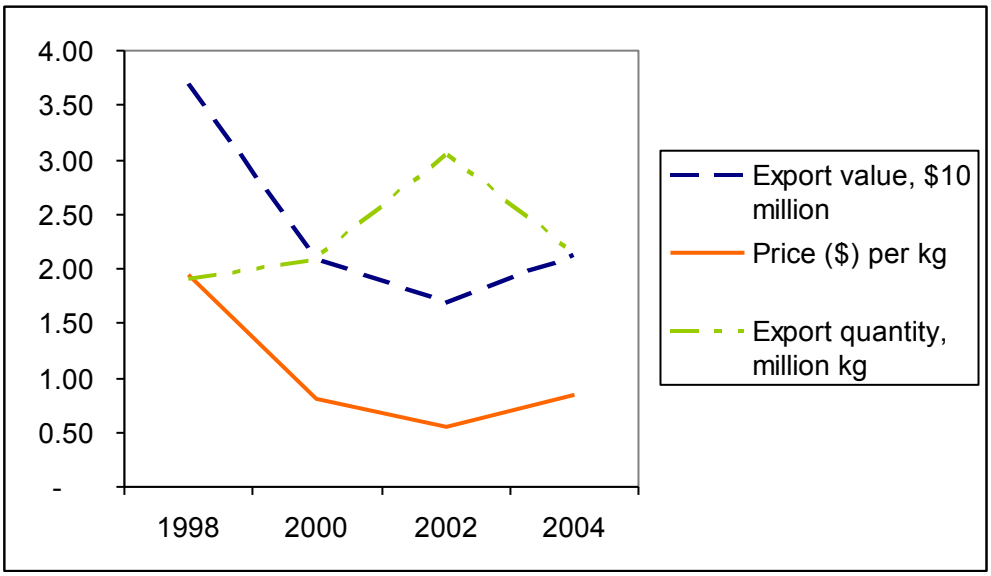
Vietnamese fruits and vegetables have met different fortunes in the Japanese market, but overall Japan has emerged as a relatively stable market for Vietnamese produce. This stability stands in marked contrast to Vietnam's traditional market for fruits and vegetables — China — where Vietnamese fruits and vegetables lost almost half their export value between 2001 and 2003 (RFIV, 2004). In recent years Japan has been the third largest importer of fruits and vegetables from Vietnam, behind China and Taiwan (GSO, 2000, 2002, 2004). China has been Japan's largest supplier of fruits and vegetables since 1998.[13]

Japan has been increasingly dependent on fruit and vegetable imports following a plunge in domestic production in the wake of the 1985 Plaza Accord.[14] Vietnamese producers have been among the beneficiaries. Vietnam's fruit and vegetable exports to Japan increased 729 percent between 1991 and 1995, 77 percent between 1995 and 2000, and 130 percent between 2000 and 2004.[15] As Figure 5 illustrates, although fruit exports peaked in 2002 vegetable exports have

[13] Japanese customs statistics, online at: http://www.customs.go.jp (May 2005).
[14] In which France, Japan, West Germany, the U.S., and the UK agreed to devalue the U.S. dollar in relation to the yen and Deutsch Mark via active currency intervention.
[15] Ibid.

grown steadily since 2001, and vegetables have accounted for nearly two-thirds of Vietnam's fruit and vegetable exports to Japan since 1999.[16] Vietnam's major fruit and vegetable exports to Japan include okra, eggplant, lettuce, pumpkin, cherry, mango, and dried foodstuffs.

Figure 6: Vietnamese Coffee Exports to Japan, 1998-2004



Source: Japanese customs statistics, online at: http://www.customs.go.jp (May 2005).

Vietnam's coffee exports to Japan reached nearly US$37 million in 1998, but the sudden downturn in global coffee prices in 1997-1998 cut the value of Vietnam's coffee exports to Japan in half by 2002.[17] Export values rebounded to 2000 levels in 2004 *(see Figure 6)*. Decreased export values over this time period were more a reflection of falling prices than reduced quantities — prices per kilogram dropped from US$1.94 in 1998 to US$0.55 in 2002 and export quantities actually increased by 60 percent from 1998 to 2002. Japan represented just 5 percent of Vietnam's coffee exports in 2002 (GSO, 2004). Vietnam has been Japan's sixth largest exporter of unroasted coffee since 2002.[18]

[16] Ibid.
[17] Ibid.
[18] Japanese customs statistics, online at: http://www.customs.go.jp (May 2005).

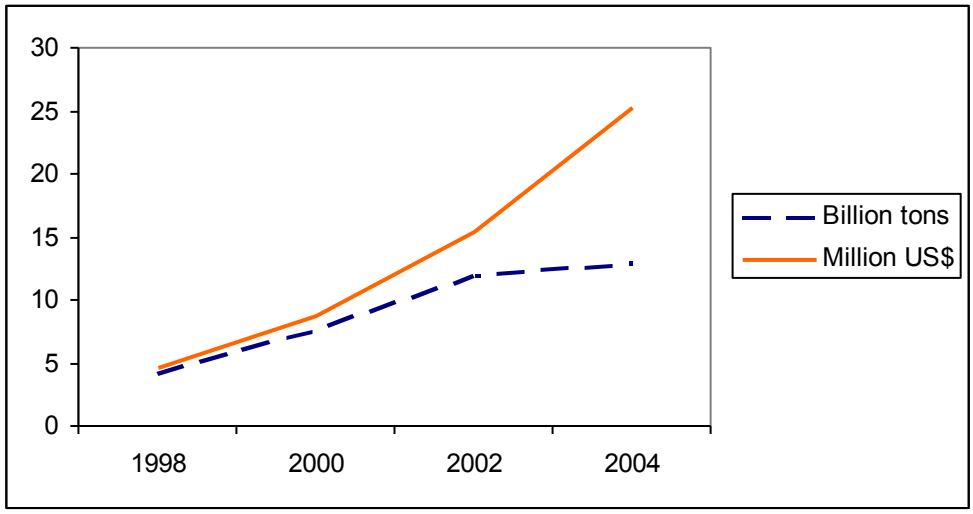
Table 1: Vietnamese Wood Product Exports to Japan, 1998-2004 (US$)

Product	1998	2000	2002	2004
Roundwood and lumber	$2,249,966	$6,302,325	$6,827,840	$8,762,999
Wood-based panels and wood chips	$30,025,924	$38,313,995	$56,022,506	$92,730,374
Wooden furniture	$38,928,000	$72,052,000	$108,275,000	n/a

Sources: Roundwood and lumber and wood-based panel and wood chips data are from Japanese customs statistics. Wooden furniture data are from Huong and Dao (2003).

Over the past five years Japan has been Vietnam's second largest importer — behind Taiwan — of wood, bamboo, and rattan products (GSO, 2000, 2002, 2004). While Taiwan is more likely to be an intermediary destination, Japan has historically been the largest importer of wooden furniture from Vietnam (Huong and Dao, 2003). Japan is also an important importer of primary and semi-processed wood products from Vietnam, and comprised a significant share of both Vietnam's wood (18 percent) and wood, bamboo, and rattan products (22 percent) exports in 2002 (GSO, 2004). Both individually and as a group, Vietnam's wood products exports to Japan climbed markedly from 1998 to 2004 *(see Table 1).*

Figure 7: Vietnamese Rubber Exports to Japan, 1998-2004

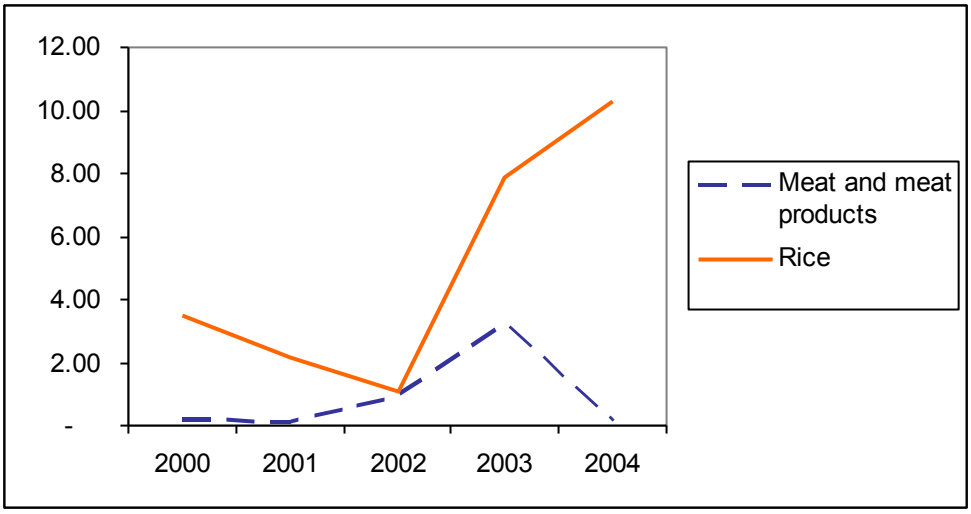


Source: Japanese customs statistics, online at: http://www.customs.go.jp (May 2005).

Japan is the fourth largest rubber importer in the world, trailing China, the U.S., and the EU. Although Vietnam's crude and manufactured rubber exports to

Japan grew more than five fold from 1998 to 2004, Vietnam accounts for only a small share (less than one percent) of Japan's rubber imports.[19] Similarly, Japan is not a major export market for Vietnamese rubber, accounting for four percent of Vietnam's total exports in 2002 (GSO, 2004). As Figure 7 illustrates, rising prices, driven by the commodity boom in China, led to heady growth in export values (64 percent increase) between 2002 and 2004 even as export quantities remained relatively flat.

Figure 8: Vietnamese Meat and Rice Exports to Japan, 2000-2004



Source: Japanese customs statistics, online at: http://www.customs.go.jp (May 2005).

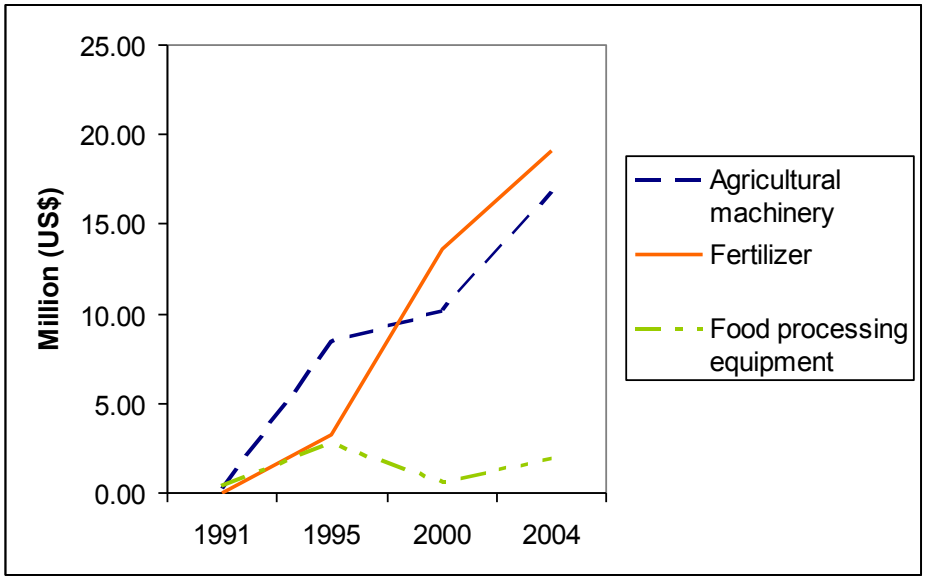
In addition to its primary exports, Vietnam also exports smaller numbers of other products to Japan. For a variety of reasons, rice — the most important agricultural crop in Vietnam at roughly one-fifth of agricultural exports in 2002 (GSO, 2004) — is not a major export to Japan. Vietnam's rice exports to Japan fluctuated wildly during the past five years, dropping by nearly one-fourth from 2000 to 2002 to just over US$1 million, before surging to $10 million in 2004. Vietnamese meat product exports to Japan suffered a similar fate, peaking in 2003 at US$3.2 million before falling to $148,000 in 2004 *(see Figure 8)*. Vietnamese tea exports to Japan grew strongly from 1991 to 2000 and peaked in

[19] Japanese customs statistics, online at: http://www.customs.go.jp (May 2005).

2000 before falling 68 percent between 2000 and 2004.[20] In addition to rice, meats, and teas, Vietnam also exports small volumes of cashews, cinnamon, and pepper to Japan.

Japan has a large chemical and farm manufacturing sector; both the farm machinery and seed industries are world leaders. Similarly, Japan has been an important exporter of agricultural machinery, fertilizers, seeds, and food processing equipment to Vietnam. Agricultural machinery exports reached US$16.8 million and fertilizer exports topped US$19.1 million in 2004 *(see Figure 9)*. Eighty-nine percent of the former were tractors and ninety-nine percent of the latter were nitrogen-based fertilizers. Most of the vegetable seeds in Vietnam are imported, and Japan and Thailand are the largest import countries (IFPRI, 2002). Japan has also been a less conspicuous source of food processing equipment for Vietnam, with exports peaking in the mid-1990s and reaching US$1.9 million in 2004.

Figure 9: Japanese Agricultural Input Exports to Vietnam, 1991-2004



Source: Japanese customs statistics, online at: http://www.customs.go.jp (May 2005).

[20] Ibid.

Investment and Aid

Japanese businesses and the Japanese government have greatly increased agriculture-related investments in the Asia-Pacific region, particularly following the appreciation of the yen in the mid-1980s and economic stagnation at home in the 1990s. As part of this trend, Japanese agribusiness has been increasingly active throughout Asia through both direct investment and contract farming. Japanese government investment in Vietnam's physical infrastructure will also continue to play a key role in reducing transaction costs for Vietnamese farmers, processing companies, and agricultural distributors.

Although more large-scale private investment has been concentrated in the fisheries sector, Japanese businesses are increasingly investing in farms in Vietnam, and throughout Asia. In Vietnam, contract farming has emerged as a potential way to link large numbers of smallholders to high value but difficult to access markets in Japan. More generally, there is consensus among Vietnamese experts that cooperation with Japanese companies is often indispensable for penetrating the Japanese market for agricultural goods (IFPRI, 2002); Meeting Japan's meticulous consumer preferences and strict phytosanitary standards often requires specialized production techniques that smallholder farmers in developing countries lack both the resources and skills to develop.

In Vietnam, cooperation with Japanese companies has taken a number of forms, ranging from company-company to company-farmer. In one instance of the latter, IFPRI (2002) describes an arrangement in Binh Duong Province where farmers are contracted to produce eggplants for a Japanese company. The company provides credit, seeds, and standards, and takes responsibility for all post-harvest activities. As many Vietnamese farmers make the transition from subsistence to commercial agriculture and informal to more formalized trade, these kinds of arrangements could play a considerable role in improving seed quality, production methods, processing, marketing, and distribution in rural Vietnam. Nevertheless, contract farming remains contentious internationally (see Baumann, 2000), as it often leaves farmers in positions of high vulnerability, can

be biased toward larger farms, and is difficult to maintain over the longer term in volatile commodity markets.

Japanese government aid has focused on developing rural and regional infrastructure; promoting agricultural, forestry, and fisheries research; and improving rural capacity in such areas as meeting international sanitary and phytosanitary regulations (MOFA, 2004). Aid has been particularly robust in Vietnam's fisheries sector and in building regional and international roads. The former has largely been through fishing port development, processing capacity support, research funding, and marine resource assessments. In the latter, Japan has provided financing for a number of high-profile, high-impact road construction and improvement projects, including Highway No. 5 (between Ha Noi and Hai Phong) and the GMS-sponsored East West Corridor (linking Myanmar and the Indian Ocean to Vietnam and the Pacific Ocean).

LONGER-TERM PROJECTIONS AND POLICY SIMULATIONS

The remainder of this report employs a Computable General Equilibrium (CGE) model and scenario analysis to examine how Vietnam's future trade patterns and domestic economic conditions will change under alternative trade trajectories, with dynamic forecasts over the period 2005-2020. In particular, this analysis evaluates various components of a bilateral negotiating strategy for Vietnam's trade policy with Japan, and the implications for Vietnam's agricultural sector.

To illustrate the diverse universe of potential outcomes for different trade and reform strategies, and to show more specifically how different negotiating options could affect the structure of Vietnam's economy and the living standards of its people, this report considers seven scenarios. *(See Table 2.)*

Table 2: Trade Policy Scenarios

Scenario	Assumptions
Baseline	Business as usual, with status quo protection levels and consensus macroeconomic growth rates; calibrated macro trends without reform or WTO accession
Reform-WTO	Coordinated external and domestic reform
USBTA	Bilateral trade liberalization under the U.S.-Vietnam Bilateral Trade Agreement; shown here for reference
JBTA1	Bilateral trade liberalization with tariff reductions only
JBTA2	JBTA1 with negotiated market access (5% annual import growth in all Vietnam export categories to Japan)
JBTA3	JBTA2 with Japanese direct investment; specifically, Japanese FDI as a percent of Vietnam GDP is raised to its ASEAN average over the period 2005-2015.
JBTA4	JBTA3 with technology transfer to agriculture and food processing (3% productivity growth)

In a simulation framework of this scale, there are large quantities of results that have relevance for economic outcomes. To keep the discussion manageable, this analysis begins with some aggregate indicators such as real GDP, depicted in Figure 8 as changes with respect to the base year normalized to 100.

Figure 10: Real GDP Growth Indexed to Year 2000=100

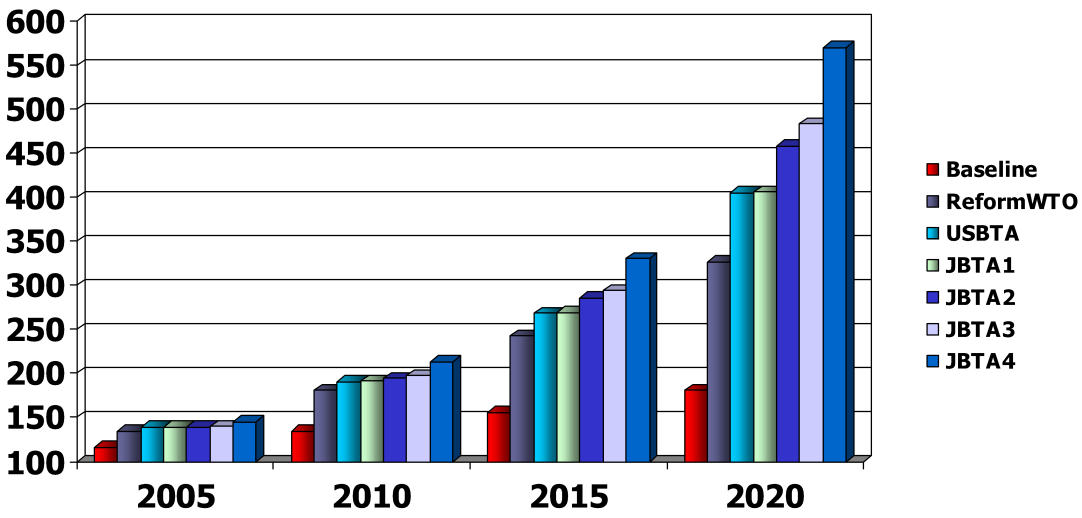
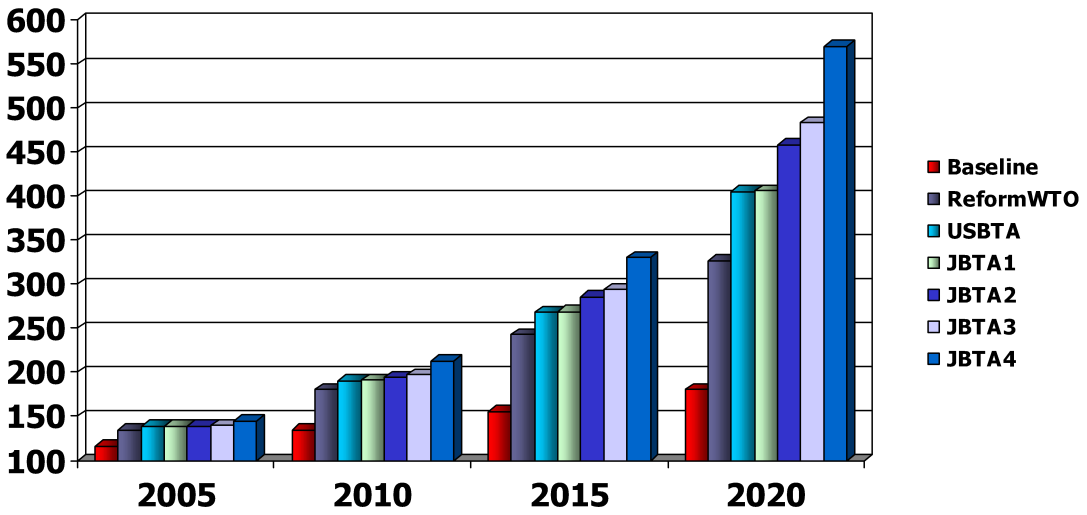


Figure 10 reveals one of the main conclusions of this report — bilateral trade negotiations must reach far beyond simple tariff removal if they are to yield substantial longer-term, real gains for Vietnam. Simple bilateral tariff abolition between Vietnam and Japan will yield aggregate benefits only negligibly larger than the existing USBTA already offers, with some trade diversion as the main adjustment. The reasons for this are made clear in the other three JBTA scenarios. First, most of Japan's substantive protection against Vietnamese exports is non-tariff protection, and thus would not be covered by JBTA1. If Vietnam instead negotiated direct market access, even based on 5 percent per year increases in existing trade shares, the result would be substantially better (JBTA2). Additional Japanese direct foreign investment (JBTA3) would improve

this result somewhat, and finally technology transfer (JBTA4) would add over 150 percentage points of baseline GDP compared to tariff removal alone.

Figure 11: Real Consumption Growth Indexed to Year 2000=100



Results for real final consumption in Figure 11 mirror those for real income, as would be expected from the relatively uniform gains for Vietnamese households under these bilateral scenarios.

Table 3: Macroeconomic Aggregates
(Percent change from Baseline in 2020)

	RefWTO	USBTA	JBTA1	JBTA2	JBTA3	JBTA4
GDP	81	124	125	154	167	216
Consumption	43	139	142	199	225	318
Investment	76	184	186	254	297	316
Exports	111	137	137	169	179	227
Imports	72	178	181	257	293	359

Note: All results are percentage changes in real magnitudes.

Table 3 summarizes the basic macroeconomic aggregates for each scenario, illustrating the trade effects of each negotiating component. By the terminal year of 2020, tariff removal alone (JBTA1) would cause only a negligible increase in

Vietnam's exports, while negotiated market access would raise total exports by and extra 76 percentage points. Under all three negotiated scenarios, domestic investment increases sharply and sustains more rapid growth.

Table 4: Vietnam Imports from Japan
(Percent Change from Baseline in 2020)

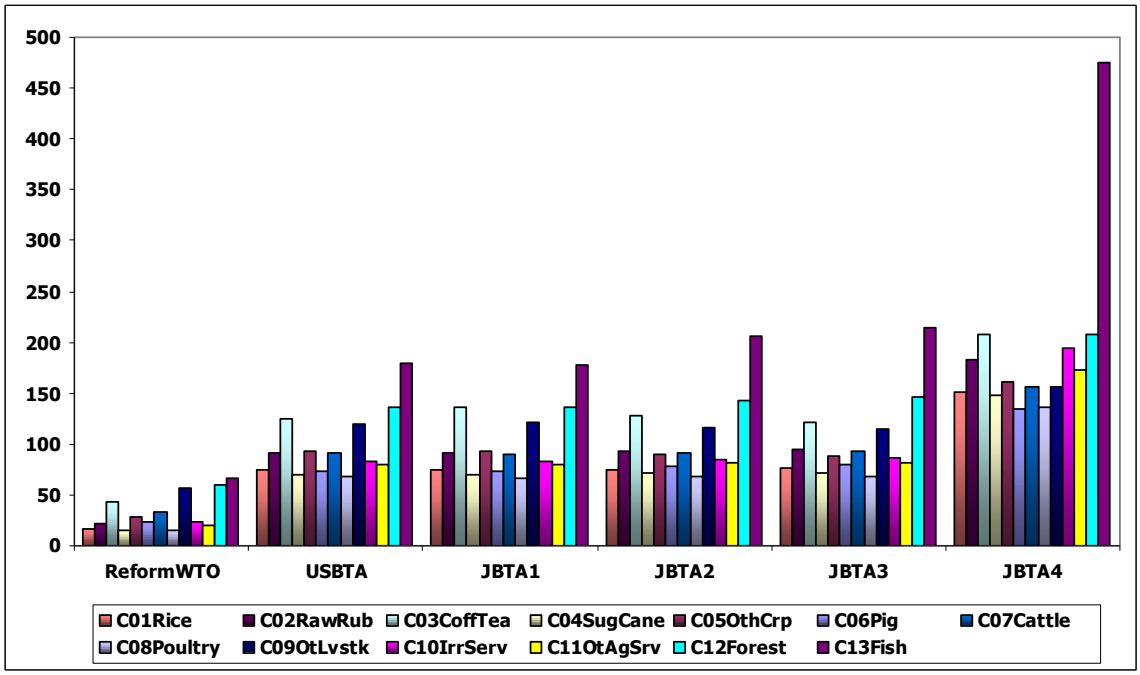
Scenario	2005	2010	2015	2020
ReformWTO	19	37	57	81
USBTA	23	55	108	187
JBTA1	31	66	122	207
JBTA2	40	92	168	291
JBTA3	42	99	184	334
JBTA4	45	108	206	378

From a bilateral perspective, Tables 4 and 5 show Vietnam's imports from and exports to Japan, respectively. Here the effects of tariff removal are more clearly visible, with imports from Japan more than doubling in JBTA1 while exports increase only 53 percent. If Vietnamese negotiators could instead achieve even modest market access (5 percent/year increases in existing exports to Japan), the results would be dramatically more favourable. Including Japanese FDI facilitates greater Vietnamese export competitiveness, and technology transfer even more so. In the latter case, Vietnamese exports jump an additional 100 percent from baseline values and significantly exceed import growth.

Table 5: Vietnam Exports to Japan
(Percent Change from Baseline in 2020)

Scenario	2005	2010	2015	2020
ReformWTO	20	41	67	99
USBTA	16	19	25	53
JBTA1	16	19	25	53
JBTA2	96	211	311	464
JBTA3	95	214	321	491
JBTA4	103	237	372	598

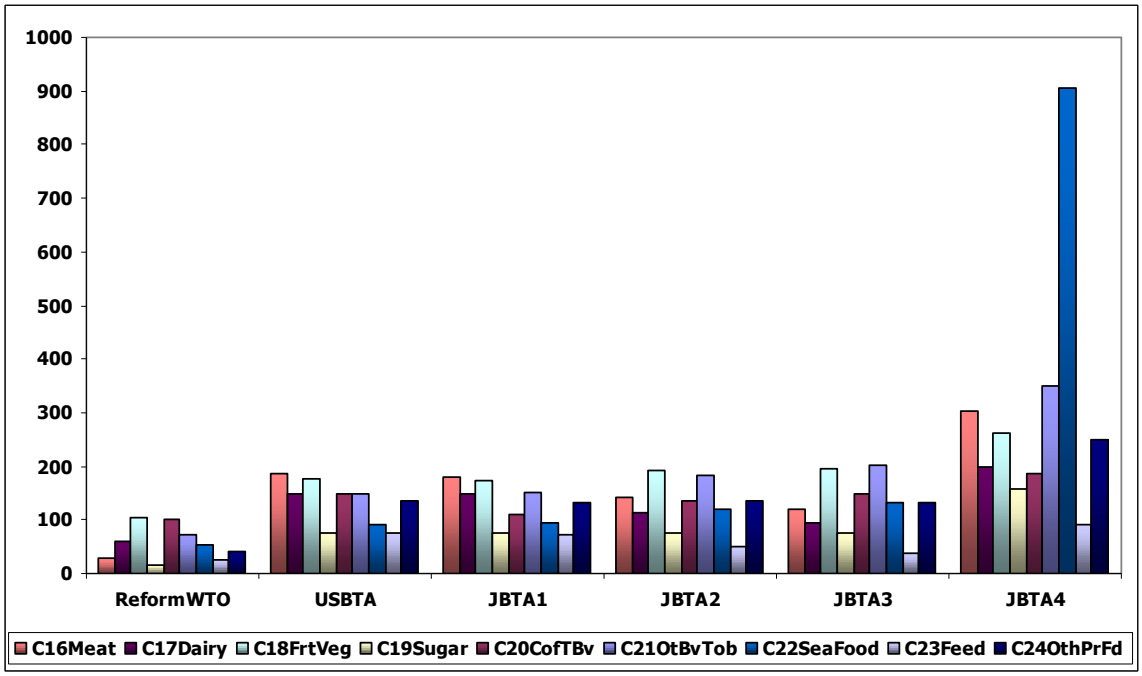
Figure 13: Agricultural Output Changes
(Percent Change from Baseline in 2020)



Figures 13 and 14 summarize the output effects of the six policy scenarios on agriculture and food processing activities. Generally speaking, the USBTA has the most determinate effect on agriculture in the absence of significant Japanese investment and technology transfer. Without these, most output growth is directly in agriculture rather than food processing, resulting in lower value added (low wage trap) for rural households and food employment generally. These properties of the USBTA, which tend to reinforce Vietnam's traditional comparative advantages, are discussed elsewhere in this series.

When complementary investment and technology transfer are added (JBTA3 and JBTA4), significant output growth can be achieved in food processing and its upstream primary agricultural supply sectors. The result is greater economy-wide output growth and higher average value added in the agro-food supply chain. Higher productivity in food processing is critical to expanding its capacity because of reliance on external markets, as shown in the next two figures.

Figure 14: Food Processing Output Changes
(percent Change from Baseline in 2020)



Figures 15 and 16 summarize percentage export changes for the same agriculture and food processing sectors. These results also indicate important ways in which negotiated trade policy can influence the evolution of the country's international comparative advantage. In the WTO, USBTA, and tariff removal scenarios, Vietnam's traditional comparative advantages as a raw food exporter are reinforced, food processing growth is limited, and the country remains in a relatively low wage primary export trap.

As has already been observed, the investment and technology transfer scenarios increase productivity in higher value added food processing, making these sectors more competitive internationally and stimulating both output and input demand. The result is a meteoric rise in higher value added seafood production, primarily because technology and enabling investment permit Vietnam to process fishery output for higher price markets in Japan and elsewhere. Expanding this kind of higher value capacity is essential to sustaining rising wages in Vietnam, but it will not happen without determined negotiating efforts to shift more advanced processing capacity to Vietnam.

Figure 15: Agricultural Export Changes
(Percent Change from Baseline in 2020)

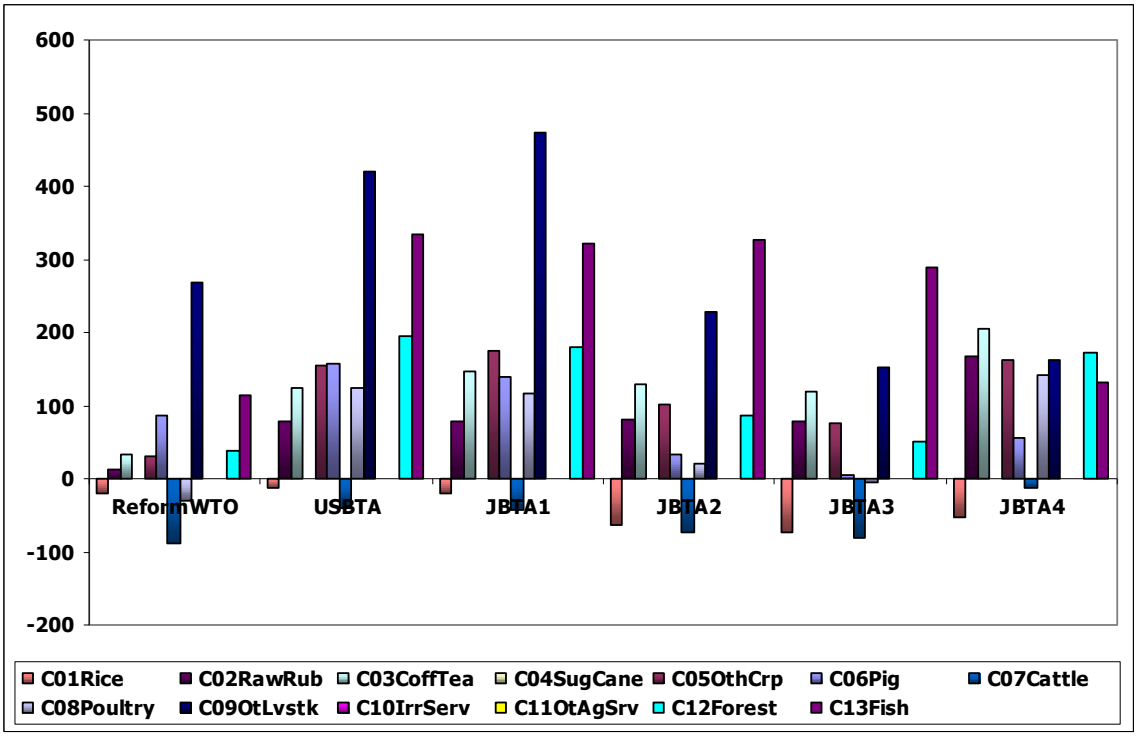


Figure 16: Food Processing Export Changes
(percent Change from Baseline in 2020)

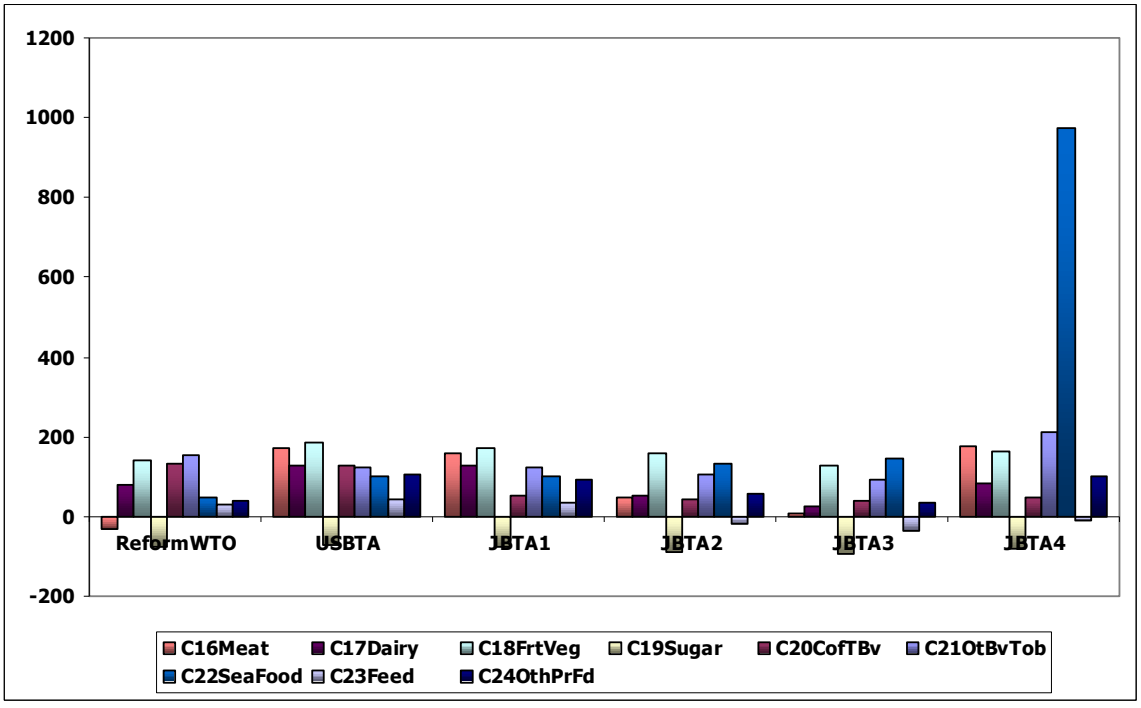
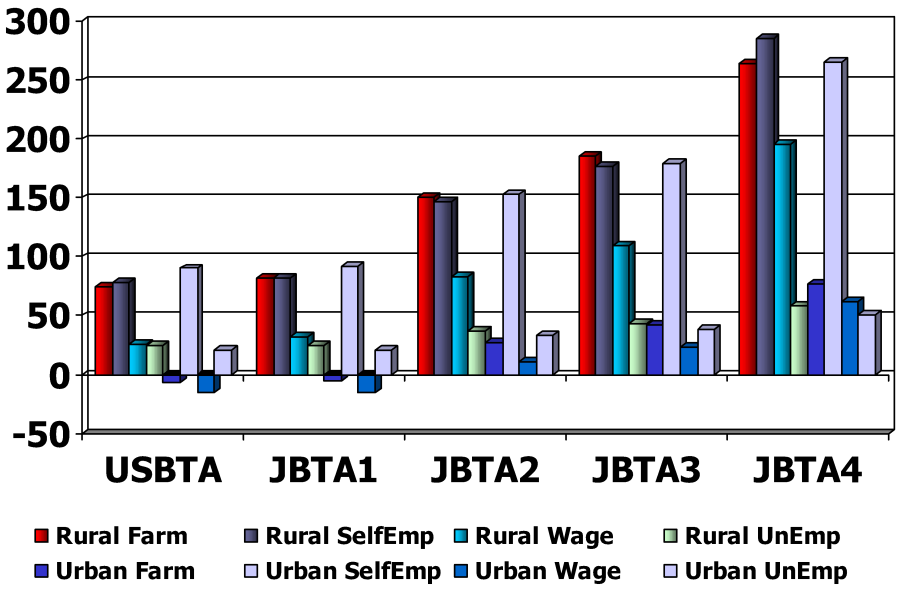


Figure 17: Real Household Income Growth
(percent change from Baseline in 2020)



An important policy priority of this MARD research is to better understand the effects of trade policy on poverty, especially among the country's rural poor majority. For this reason, it is particularly significant to examine how trade negotiations can influence the real incomes of rural households. Viewing real household income growth through the lens of the latter five scenarios, again results suggest that bilateral tariff reductions alone will result in little difference from the USBTA. However, more determined negotiations can add 100 to 200 percentage points to rural income growth by 2020. The primary reason for this is increased profitability of food production, resulting from a combination of domestic and external demand growth. As the value added in agro-food production increases wages rise sharply among all rural households and the urban self-employed (including many retail food intermediaries).

CONCLUSIONS AND RECOMMENDATIONS

Over the last decade, Japan has emerged as a strategic trade partner for Vietnam, both as an export market and as a source of imports and foreign investment for supporting its transition to a modern, industrial economy. Despite being recently eclipsed by the U.S. as Vietnam's largest trade partner, trade with Japan plays and will continue to play a fundamental role in the Vietnamese economy.

Trade relations with Japan are particularly salient for Vietnam's agricultural sector. Agricultural exports have grown in tandem with aggregate exports, and agricultural products comprise nearly a quarter of Vietnam's total exports to Japan. Despite higher export levels, Japan's potential as an export market for Vietnamese agricultural products is still far from reaching its potential. Japan is already the world's largest net importer of agricultural products, importing about 60 percent of its food each year, and with an aging agricultural sector imports are set to increase. Gaining a stronger foothold in Japan's evolving market for agricultural and food products will increasingly be a strategic priority for Vietnam's trade policy.

This analysis argues that Vietnam-Japan bilateral trade negotiations must extend beyond attention to traditional tariff reductions in order to produce greater benefits for both Vietnam's agricultural sector and its economy as a whole. As detailed in the figures above, reductions in nominal tariff barriers will stimulate only relatively small effects on trade and GDP growth in Vietnam. Alternatively, an agreement that negotiates greater market access for Vietnamese agricultural products, encourages higher levels of Japanese investment, and fosters technology transfer could have dramatic benefits for Vietnam's economy, its agricultural sector, and household income.

In this respect, complementarities between Vietnam and Japan are ripe for deeper trade and investment integration. Japan is a high income economy with significant savings and low rates of return on domestic capital. By contrast, Vietnam is a low income country with relatively scarce domestic capital resources and correspondingly high rates of return on real investment. In addition, Japan is a plentiful source of advanced technology in sectors like food processing, while food processing remains an emergent sector in Vietnam. These complementarities suggest that the two economies could mutually benefit from more extensive trade and investment linkages, particularly in value added agricultural production.

Higher Japanese investment in and technology transfer to Vietnam's agricultural and food processing sectors would, in turn, provide a bridge for Vietnamese businesses and farmers to meet stringent health standard and cater to sophisticated consumer tastes in Japan. Higher value added in agriculture and an internationally competitive agro-food sector would help Vietnam escape the low wage trap that still characterizes its agricultural sector. Investment and technology concentrated in food processing would lead to increases in non-farm employment and demand for primary agricultural inputs, thus increasing rural wages and promoting more balanced growth for the economy as a whole.

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