VIETNAM'S BILATERAL TRADE AGREEMENT WITH THE UNITED STATES: ECONOMIC PROJECTIONS TO 2020 AND IMPLICATIONS FOR AGRICULTURE

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Executive Summary

This study presents an empirical assessment of the long term economic effects of Vietnam's bilateral trade agreement with the United States (USBTA). Generally speaking, our results indicate that, if this agreement were adhered to by both parties, Vietnam would benefit from accelerating trade and attendant domestic growth effects. However, it is also clear from our analysis that these benefits will remain modest in the absence of comprehensive and complementary domestic economic reforms. Passive external liberalization, even when coupled with determined domestic reform, implying that the domestic economic agenda is as important as the external one for realizing the country's economic potential. Finally, our analysis shows that capital insufficiency is a very serious constraint on Vietnamese economic growth and diversification. Capital market reform and other policies to promote foreign direct investment can play an essential role in dynamic and sustained economic development for the country, in agriculture and elsewhere.

Using a dynamic forecasting model, our estimates indicate that, while agreements like the USBTA are essential to fuller Vietnamese participation in the global economy and economic modernization generally, they are only a partial step toward realizing the country's great economic potential. In particular, we offer the following salient observations:

1. The combined effect of Vietnam's WTO offer and the USBTA agreement represents a substantial reduction in nominal import protection and other barriers to trade, but the gains the country could enjoy from external liberalization will be seriously limited unless they coincide with comprehensive and sustained domestic economic reform.

2. In the absence of other measures, the WTO offer will lead to intensification of Vietnam's traditional comparative advantages. This would narrow the basis for development, modernization, and productivity growth, and not be in the economy's best long term interest. It can be avoided by complementary policies that promote economic diversification and negotiated external market access. Particular attention should be paid to intensifying bilateral and regional arrangements with prominent trade partners.

3. The single most important example of such a negotiated agreement is the the USBTA. Our results indicate that this agreement has the potential to nearly double the gains from Vietnam's existing trade initiatives (including WTO accession), significantly diversifying its export demand and making important contributions to capital formation and technology transfer.

4. Our results also indicate the importance of policies that will leverage foreign savings for domestic growth in Vietnam, i.e. policies to promote foreign direct investment (FDI). In this context, it is essential to recognize the importance of capital market reform to allow more efficient allocation of investment across the economy and greater foreign capital inflows.

5. The most important insight emerging from this analysis is the essential complementarity between domestic and external economic reform. Both are necessary, but neither is sufficient, to realize the great economic potential of Vietnam. To put it another way, the effort to reform internally cannot be fully rewarded without external reform and, conversely, external efforts to liberalize economic relations, like the US bilateral agreement, cannot be fully rewarded without commitment to complementary domestic reforms.

Introduction and Background

The U.S.-Vietnam relations have been gradually improving since the end of the American War. In 1994 the Clinton administration lifted the trade embargo in attempt to improve trading between the U.S. and Vietnam. However, both countries did not reach full diplomatic relations. The Vietnamese economy experienced growth due to increases in trade and foreign investments, but progress was hindered by the economic crisis in Asia during 1997. Since much of the Vietnamese economy was dependent on investments from many Asian countries such as Japan, Korea, Hong Kong, and Taiwan, the Asian economic crisis had an adverse effect on the Vietnamese economy.

There was another attempt at formalizing diplomatic relations between the U.S. and Vietnam. In December of 2001, the U.S.-Vietnam Bilateral Trade Agreement was ratified by both parties. The Agreement marks a major shift of economic policy direction for Vietnam, creating more openness to the outside world; promoting economic reform and market principles, transparency in law and regulatory policy, and helping Vietnam to both integrate itself into the Pacific regional economy and build a foundation for future entry into the World Trade Organization. There are six chapters in the BTA: (1) market access for industrial goods and farm products; (2) intellectual property; (3) trade in services; (4) investment; (5) business facilitation; and (6) transparency. In each case, it sets clear and specific commitments and timetables, which will go into effect after the agreement is implemented through a Congressional decision to extend Normal Trade Relations (MFN) to Vietnam.

In trading goods, Vietnam has committed to general trade principles that are consistent with the WTO practices, including reducing tariffs and abolishing non-tariff restrictions such as quotas, ensuring trading rights for foreign and Vietnamese businesses, and others. Some of the major commitments include:

<u>Trading Rights</u>: Vietnam will grant rights for both Vietnamese and foreign businesses to import and export, generally phased in over 3-6 years.

<u>National Treatment</u>: Vietnam will apply national treatment for imports in areas including standards, taxes and commercial dispute settlement.

<u>Tariffs:</u> Vietnam will guarantee MFN-level tariffs for U.S. goods, and cut tariffs on a wide range of agricultural and manufactured goods of interest to American exporters from most cases by a third to a half, from current levels averaging approximately 20%.

<u>Non-tariff Measures</u>: Vietnam has agreed to eliminate all quantitative restrictions on a range of industrial and agricultural products (e.g., auto parts, citrus, beef), over a period of 3-7 years, depending on the product.

<u>Import Licensing</u>: Vietnam will eliminate all discretionary import licensing, in accordance with the WTO agreement.

<u>Customs Valuation and Customs Fees</u>: Vietnam will comply with WTO rules – using transactions value for customs valuation, and limiting customs fees to cost of services rendered – in two years.

<u>Technical Standards and Sanitary and Phytosanitary Measures</u>: In accordance with the WTO standards, technical regulations and sanitary and phytosanitary measures will be applied on a national treatment basis, to the extent necessary to fulfill legitimate objectives (e.g., to protect human, animal, or plant life or health).

State Trading: State trading will be carried our in accordance with the WTO rules (e.g., state trading enterprises make any sales and purchases only in accordance with commercial considerations).[9]

In regards to intellectual property rights, Vietnam will be required to implement the "WTO-level patent and trademark protection within one year, and copyright and trade secret protection within 18 months. It will also take further measures to strengthen intellectual property protection in other areas, for example protection of encrypted satellite signals."[10]

Vietnam will also accept the guidelines of the WTO's General Agreement on Trade in Services, which guarantees protection for the existing rights of all foreign service providers in Vietnam, and making specific commitment in a range of sectors. Some of the major areas include:

Telecommunications: Vietnam will accept the principles of the WTO's Basic Telecommunications Reference Paper, requiring a pro-competitive regulatory regime and cost-based interconnection fees. It will also make commitments to liberalize the basic and value-added telecommunications markets.

Financial Services: In terms of insurance, for life and other "non-mandatory" sectors, U.S. firms will be able to form joint ventures with a 50% equity limit after three years, and to hold 100% equity after five years. In "mandatory" sectors such as motor vehicle and construction insurance, U.S. firms will be able to hold 100% equity after six years. In regards to banks, U.S. banks will be allowed to open branches in Vietnam and have the ability to form joint ventures with equity between 30-49%; after 9 years, 100% U.S. subsidiary banks will be allowed. Over time, Vietnam will allow U.S. banks to offer such services as deposits in local currency, credit cards, ATM machines and others. U.S. securities firms will be allowed to open representative offices in Vietnam.

Professional: With regard to legal services, Vietnam will allow 100% U.S. equity in legal firms, including branches. Law firms opening branches in Vietnam will receive 5-year, renewable licenses, and may consult on Vietnamese laws. U.S. accounting firms, architectural firms, and engineering firms will be able to hold 100% equity. Vietnam will grant licenses to U.S. accounting firms on a case-by-case basis for three years, with no limits afterwards. U.S. firms will be able to provide services to foreign invested firms for the first two years, and to Vietnamese firms afterwards.

Other: Vietnam has also made specific commitments in a wide range of other services fields, including computer services, advertising, market research, management consulting, construction, distribution, private education, health services such as hospital and clinics, and the travel and tourism sector.[12]

Vietnam will make a series of commitments that will create a safe environment for investors by reducing paperwork and in almost all cases ensuring national treatment for foreign investors. These include "protection against expropriation of U.S. investments in Vietnam, and rights to repatriate profits and conduct other financial transfers on a national treatment basis; phasing out such measures as local content requirements and export performance requirements within five years; ending almost all investment screening and discriminatory pricing; and reducing government controls and screening requirements for joint ventures."[13]

With respect to business facilitation, Vietnam will guarantee the right for U.S. businesses to conduct routine business practices, such as setting up offices, advertise and conduct market studies.

The last chapter of the BTA is in regards to transparency and right to appeal. Vietnam will be required to provide advance notice of all laws, regulations and other administrative procedures relating to any matter covered in the

[9] Barshefsky, Charlene. "The U.S.-Vietnam Bilateral Trade Agreement," Business-In-Vietnam.Com. [Online]. Available: http://www.business-in-vietnam.com/vnBTA.html [2003, April 8]

[10] ibid
[12] ibid.
[13] ibid.3

agreement; publish all laws and regulations; and inform the public of effective dates and government contact points. All laws governing issues covered in the agreement must be made public and readily available. Vietnam will designate an official journal in which all such measures will be published. They will also commit to uniform, impartial and reasonable application of all laws, regulations and administrative procedures. Lastly, Vietnam will be required to form administrative or judicial tribunals for review and correction (at the request of an affected person) of all matters covered in the agreement, and afford the right to appeal the relevant decision. Notice of decisions upon appeal and reasons for decisions appealed should be provided in writing.[14]

The Agreement will be effective for three years, but it can be amended to extend, depending negotiations between the U.S. and Vietnam. The BTA will make Vietnamese goods cheaper in the U.S. because of reductions in U.S. Customs Duties required under the BTA. Under the Agreement, the average U.S. rate of duty on imports from Vietnam will drop from an average of “nearly 40% to 3%.” It would be more profitable for Vietnam to export their products to the U.S. Most of the expected growth in exports from Vietnam to the U.S. will come as a result of this reduction in tariffs. Exports of footwear and textile and apparel products (garments) should show the biggest gains in the initial period. Most of Vietnam’s requirements to lower tariff barriers are required to be phased in over 3 years from the date of signing of the BTA. Tariffs are expected to decrease an average of 10-20%.[15]

The signing of the U.S.-Vietnam Bilateral Trade Agreement is an important step as most of the contents of this Agreement are similar to questions raised by the WTO. The signing of the Agreement would also facilitate Vietnam’s entry to the World Trade Organization.

Tariffs are expected to decrease an average of 10-20%.15

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Overview of Initial Conditions

The basic dataset for the analysis reported here is a new Social Accounting Matrix for Vietnam. Estimated for the year 2000, this is the most up-to-date and detailed SAM for the country, and we use it to calibrate our baseline and policy scenarios.

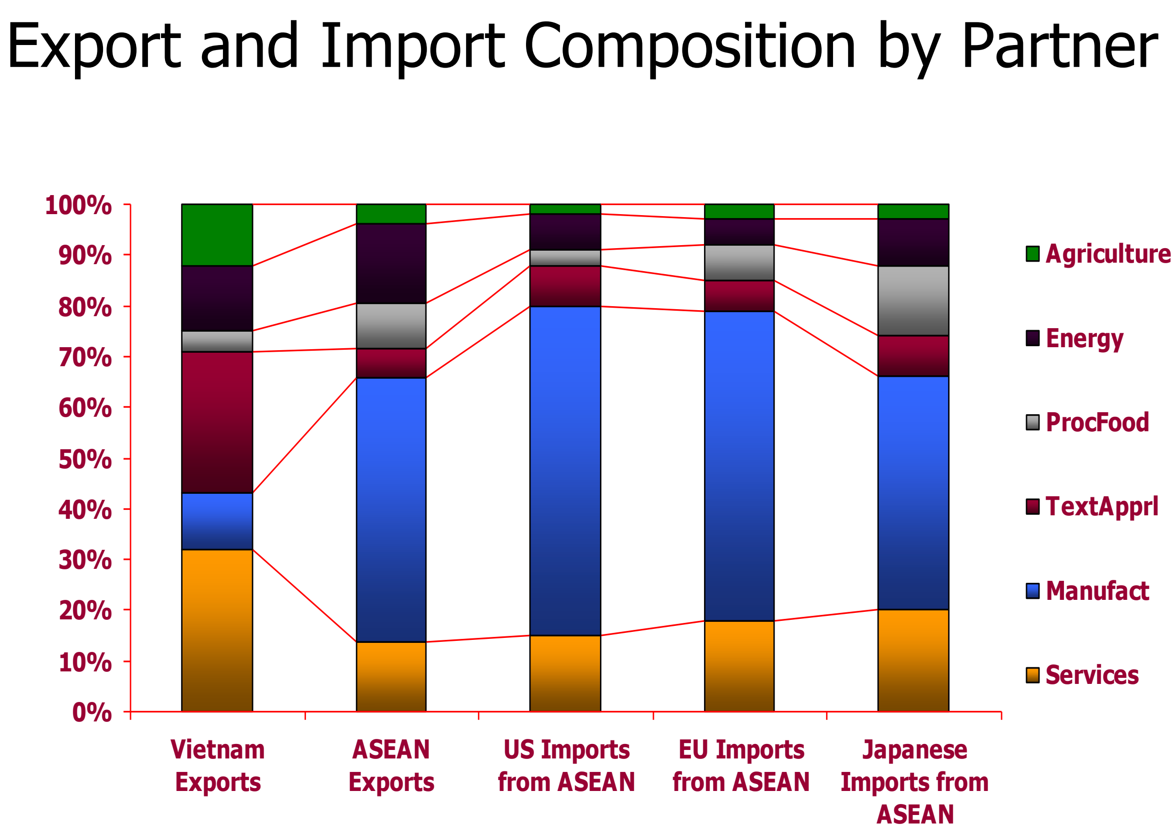
The new SAM is more fully documented elsewhere, but its basic characteristics are the following:

1. New GSO Input-Output Table
2. 112 domestic production activities
3. 114 commodities
4. 14 factors of production
5. 12 labor categories
6. Capital
7. Land
8. 12 household types, sampled from the VLSS
9. 3 enterprises (Private, Public, and Foreign)
10. State (detailed fiscal instruments)
11. Consolidated capital account
12. 194 international trading partners

[14] ibid.

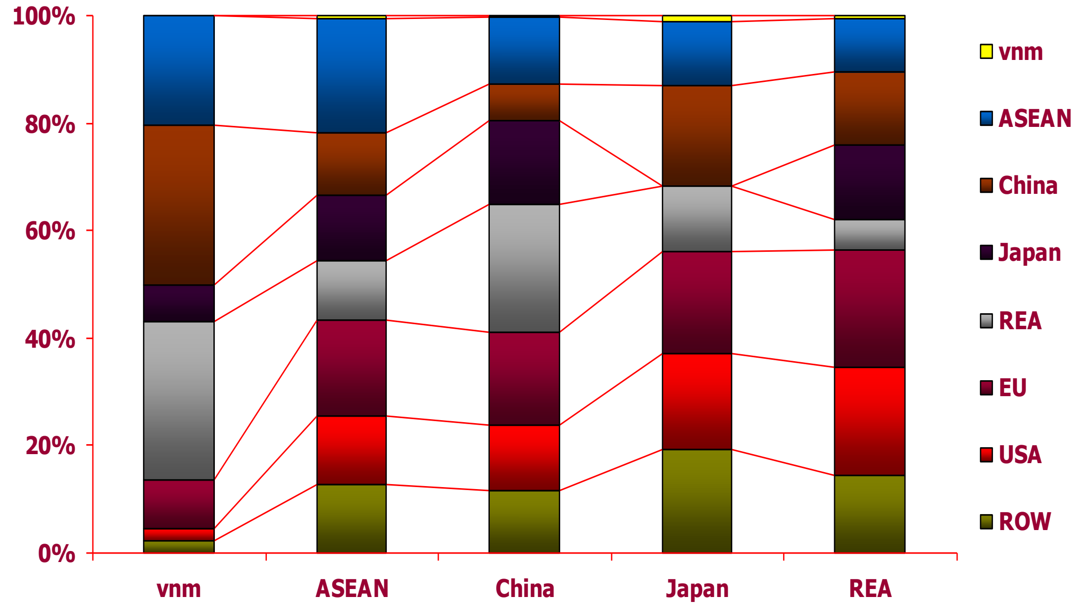
[15] Runckel, Christopher W. “The Trade Outlook with Vietnam,” Business-In-Vietnam.Com. [Online]. Available: http://www.business-in-vietnam.com/vnBTA.html [2003, April 8]

Before discussing the simulated policy scenarios, we want to make a few observations about the initial conditions for Vietnam as these are revealed in the new SAM. Consider first of all the sectoral composition of trade. The following figure indicates two very important features of Vietnam's existing trade patterns. Firstly, the year 2000 composition of Vietnamese exports is not typical of ASEAN. This is particularly true of higher wage manufacturing, which is seriously under represented in Vietnamese exports. Thus Vietnam generally offers lower wage goods to the world market than its neighbors, however, yet the last three columns indicate that the opportunities for marketing higher value-added products already exist. The three largest importing regions, US, EU, and Japan all have ASEAN imports with high manufacturing concentrations. Thus we conclude that the promise of higher value added exports exists for Vietnam, but remains unfulfilled.

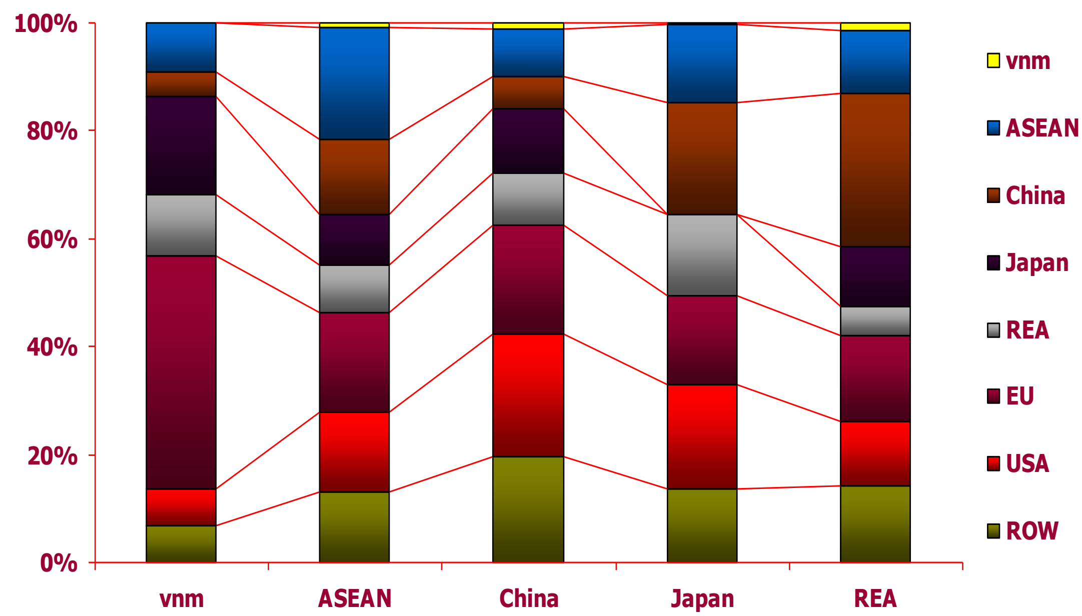


The next two diagrams indicate the base year direction of trade for exports and imports, respectively. In these results, it is apparent that Vietnam is embedded in a complex trade matrix that differs significantly from its neighbors and is bilaterally quite imbalanced. For example, Vietnam has much larger import than export shares with respect to China, while the reverse is true of the EU. Thus, for example, Vietnam offsets a significant current account deficit with respect to China with a current account surplus with the EU. Vietnam's trade dependence is also much different from the ASEAN average, which exhibits more balanced regional diversification.

Direction of Trade: Imports by Origin



Direction of Trade: Exports by Destination



Scenarios and Results

To analyze the future effects of the trade agreement, the simulation model was run for a variety of alternative scenarios.

Baseline

After specification and construction, the model was calibrated to a baseline time trend for the period 2000-2020. This means the model was calibrated statically to the 2000 Vietnam social accounting matrix (SAM) and then run forward annually at growth rates corresponding to baseline (Baseline) consensus real GDP growth forecasts for Vietnam.[1] This time path was then used as a baseline for dynamic counterfactuals of four different types.

WTO

In this scenario, it is assumed that Vietnam's current offer to the WTO is accepted, the country joins the organization and conforms to these commitments, but the domestic economy is not reformed and Vietnam remains on BaU trends for productivity growth. In this case the benefits of fuller participation in the international economy are severely limited by the economy's inability to adjust to new market realities. International prices are transmitted more efficiently to domestic institutions, but structural rigidities prevent resource reallocation and structural adjustment to develop the economy's relative strengths and defer less efficient production to foreign sources.

WTO+Reform

This scenario includes the same external policy, i.e. WTO accession and implementation of the agreed offer, but also assumes that domestic reforms are implemented to achieve productivity growth rates comparable to other dynamic reforming economies. This scenario is calibrated to protection rates from the Vietnamese WTO offer, and also to sectoral productivity growth estimates for China over the period under consideration (2000-2020). Particularly from its relatively early stage of development, Vietnam should be quite capable of replicating Chinese productivity growth if it demonstrates a real commitment to extensification and intensification of domestic economic reform. Should this double reform scenario prove politically feasible, benefits of globalization would be dramatically increased for Vietnam.\

Vietnam-U.S. BTA (USBTA)

As it stands, the current Vietnamese offer to the WTO will lead to significant intensification existing of patterns of comparative advantage. This could compromise the country's development goals by increasing specialization, export market risk, and trapping the economy in traditional primary and unskilled labor intensive activities. To overcome this tendency, Vietnamese trade negotiators should actively pursue parallel bilateral, regional, and other trade agreements that can diversify its export orientation.

The following diagrams show the composition of East Asian regional exports and imports in the 2000 base year. This reveals several well know issues, like high import dependence and low export orientation toward China. More generally, however, it is apparent that Vietnam trade orientation is not representative of the ASEAN region as a whole, nor does it fully exploit the diversity of import demand arising from the world's leading economies. It could be argued that Vietnam represents an earlier stage of economic development than the average ASEAN

[1] The latter estimates we obtained as averages from IMF, DRI, and Oxford Econometrics.

level, with greater reliance on labor intensive and low skilled (low wage) agriculture, textiles and apparel, and services. More importantly, demand patterns from ASEAN's largest trade partners offer more diversified opportunities, and Vietnam could benefit by shifting its production capacity in the direction of these large markets. Certainly, on this evidence it is reasonable to expect that the Vietnam-US BTA could stimulate export growth and diversification for Vietnam.

To capture this in our trade scenario, we assume that the US diverts its demand toward Vietnam over he period 2000-2020 in such a way that US imports from Vietnam rise to the same percentage of US ASEAN imports as Vietnam's percentage GDP in ASEAN GDP.

Vietnam-U.S. BTA with Agricultural Productivity Growth (USBTAg)

One of the most serious constraints on sustainable growth for Vietnam will be continued economic participation of the country's rural majority. The main form that this will take over the 2000-2020 time period is marketing of agricultural output. For this reason, productivity growth in agriculture and sustained policy attention to rural development will be essential to Vietnam's sustained development. Analyzing the consequences of alternative development strategies, rural sector policy consistently emerges as a critical determinant of overall success and sustainability. In particular, countries that emphasized and facilitated rural development at early and middle stages grew relatively fast and equitably (e.g., Taiwan, South Korea, and Indonesia). Those countries typically encouraged agricultural output growth through a variety of measures, including investment in rural infrastructure, adaptive research, dissemination of appropriate technology and local institutions. Governments of these countries also achieved a relatively more equal distribution of wealth and assets, using a combination of land reform measures to insure a more level playing field at the onset of the development process.

By contrast, countries which discriminated against the rural sector early on were more likely to suffer agricultural stagnation, low overall growth rates, and persistent inequality. Such "urban bias" has been endemic to of most Sub-Saharan African nations over the last half century, contributing decisively to episodes of stagnant or declining per capita food production and malnutrition. Many African governments taxed their agricultural sector –particularly small scale producers of domestic food crops - to capture a presumptive "agricultural surplus" and finance incipient industrialization. Much of these resources were wasted on white elephant projects, rent seeking, and outright corruption. Many (and often most) farmers in these countries continue to face a combination of market access barriers and fiscal burdens that seriously undermine the incentive to produce beyond subsistence. It is no exaggeration to claim that these exploitative policies against agriculture have contributed to short-circuiting the growth and development process in much of Africa.

Relatively unimpressive growth and equity performance in many Latin American countries is adducible to a similar combination of extremely uneven land distribution and distortionary poclicies. Extreme dualism between ontinues to be an obstacle to equitable growth there, and large segments of the population remain marginalized. In populous East, Southeast, and South Asia, the role of the rural sector is more complex. Because of their large absolute and relative populations, rural communities in large Asian economies constitute an important reserve of industrial labor for industrial growth and, it is hoped a large potential consumer population. Obviously, national development and rural development must go hand in hand in these countries. In China today, for example, a critical issue is development of the rural areas to create a larger domestic market for many (urban-based) industries suffering from excess capacity.

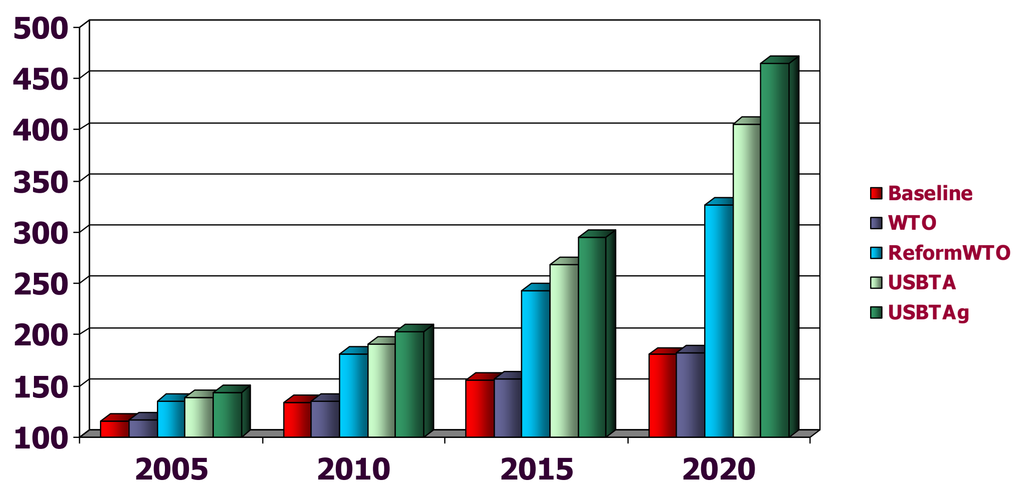
To see the importance of agricultural productivity growth, we defined a USBTAg scenario, which allows total factor productivity in Vietnamese agriculture to grow a 2 percent per year over the 2000-2020 period. This rate is not unrealistic, but it has important implications for sustainability and the composition of growth between the rural and urban sectors.

Results and Analysis

Macroeconomic effects of the four scenarios are represented in the next figure, which displays an index of projected Vietnamese real GDP growth, using 2000 as a reference value of 100. In terms of aggregate growth effects, these scenarios clearly fall into three general categories: low, moderate, and high. The Baseline scenario holds to consensus growth rates averaging 2-4% over the period 2000-2020. It is rather striking that the WTO scenario makes only a very marginal improvement on this, but this fact reveals something important about the realities of global market participation – economic readiness. If the Vietnamese economy were to passively open itself to external markets, without at the same time committing to the reforms needed to enable domestic institutions to capture the opportunities globalization presents, most of the benefits would accrue to Vietnam's trading partners. This condition resembles the experience of some post-colonial economies, in Africa and elsewhere. They lacked the intuitional strength or sophistication after independence to be equal partners in trade-based economic development. The result of this was net resource transfers to their trade partners and chronically low investments in human and nonhuman capital. The experience of dynamic Asian economies was very different, largely because their governments made serious commitments to readiness in terms of market reform, institutional modernization, education, and infrastructure development.

The most prominent current example of this readiness is the economy of China, where government, maintaining a strict distinction between political and economy reform, has made dramatic progress in the latter area with determined liberalization and modernization. The result has been unprecedented and sustained productivity growth in a domestic economy that in many other ways resembled that of Vietnam. Assuming that Vietnam committed to the same path of economic reform, the real benefits of WTO accession would be captured at home and, by 2020, real GDP would be nearly double the Baseline or WTO levels representing no domestic reform.

USBTA – Real GDP Growth



NB: Results indexed to year 2000 = 100.

How might gains from external liberalization be even greater? To answer this question, we should reflect on factors that limit gains from trade-driven expansion. The main ones are excessive specialization in traditional (low wage) activities and capital insufficiency that limits the creation of domestic production capacity and higher skill/wage employment. Passive WTO-style opening of the economy only intensifies Vietnam's tradional comparative advantages in resource intensive, low wage production. When, by contrast, Vietnam can negotiate market access for a spectrum of products that more nearly represents the ASEAN average, the growth effects are dramatic. Higher wage employment and capacity expansion to meet increased US demand again nearly doubles Vietnam's real GDP growth by 2020. Clearly, this kind of growth dividend might justify more determined negotiating efforts such as the USBTA.

Macro results

The problem of capital insufficiency is an acute one in Vietnam, effecting nearly every aspect of public and private sector activity. For example inefficient transport and communications infrastructure impose high transactions costs across the economy and reduce competitiveness. Low domestic savings constrain the pace and quality of private sector enterprise expansion and put modern technology and economies of scale beyond the reach of most production activities. More generally, capital scarcity seriously limits the private sector's ability to take the risks and initiatives necessary for broad based economic expansion. All these factors seriously undermine the country's ability to benefit from its commitment to the WTO and to sustained economic progress.

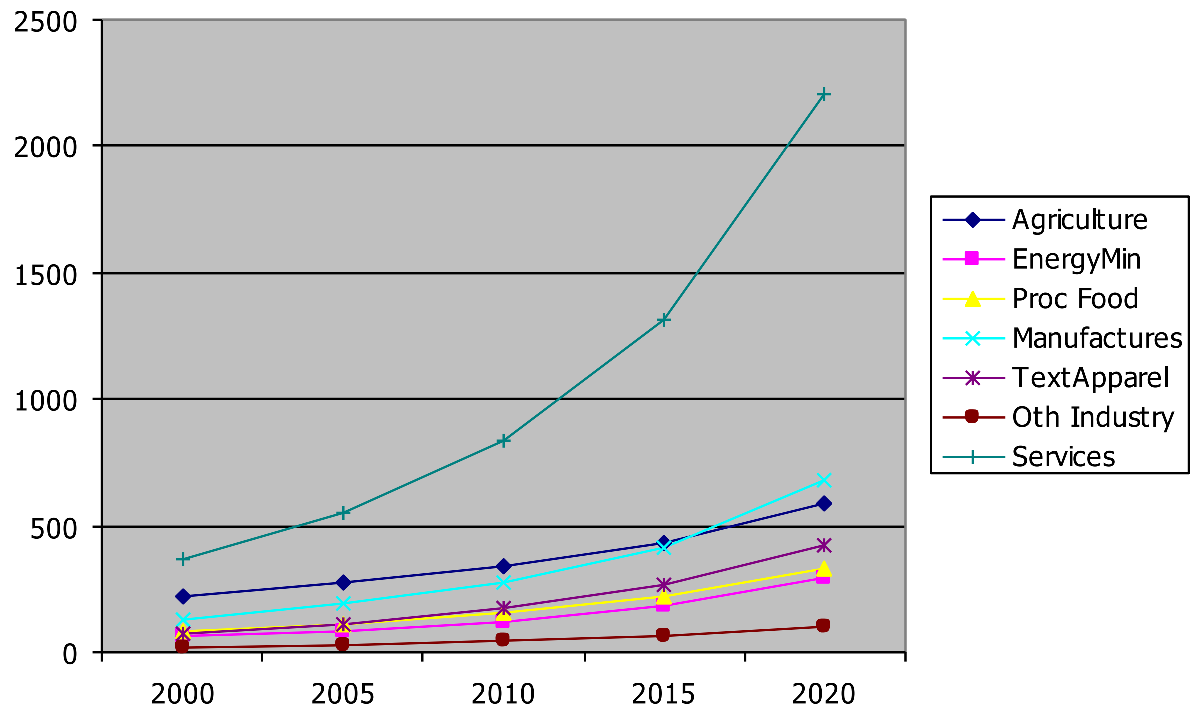
In the last scenario, we assume the government commits to the domestic and external capital market reforms necessary to increase direct foreign investment at twice the rate of real GDP growth over the next two decades. In the experience of other East Asian economies, this is a very modest expectation, but Vietnam will still need to significantly improve credit market access and transparency (for both Vietnamese and foreigners) to achieve this. Were this possible, however, our results indicate that the growth dividend would be about 25% higher in real GDP terms than under the USBTA scenario (with which it is combined here), or over 250% of WTO+Reform and about 500% higher than Baseline or WTO without reform. Again the apparent payoff for more determined policy reform appears to be very high.

To better understand the economic adjustments that underlie the macro scenario results, consider the effects on sectoral output. In the next three figures, we present sectoral output trends for a representative aggregation of ten sectors under the three most dynamic scenarios, WTO+Reform, USBTA, and FDI. Under for first, production expands steadily in most sectors, led by Services, Textiles and Apparel, and Manufacturing. Services are the dominant sector of the economy, and its growth is generally proportional to real GDP growth. Textiles and Apparel expands largely because of external market demand. Manufacturing growth is responding mainly to domestic demand growth, but exports and other supply in this sector are constrained by capital scarcity. Apart from lower aggregate growth, the main shortcoming of this scenario is that international opening without reciprocal concessions in market access and foreign investment leads to intensification of Vietnam's traditional comparative advantage in low wage, resource intensive production.

Sectoral Results

Contrast this with the sectoral results for USBTA and FDI. In the USBTA case, greater external demand stimulates both real GDP and Service sector output more than under WTO+Reform. At the same time, more diverse export demand induces faster expansion of higher-wage manufacturing, with Textile Apparel Growth falling into third place. The main constraint now is on investment in the more capital intensive high wage manufacturing. This is alleviated in the FDI scenario, and the results are striking. Now Manufacturing is growth

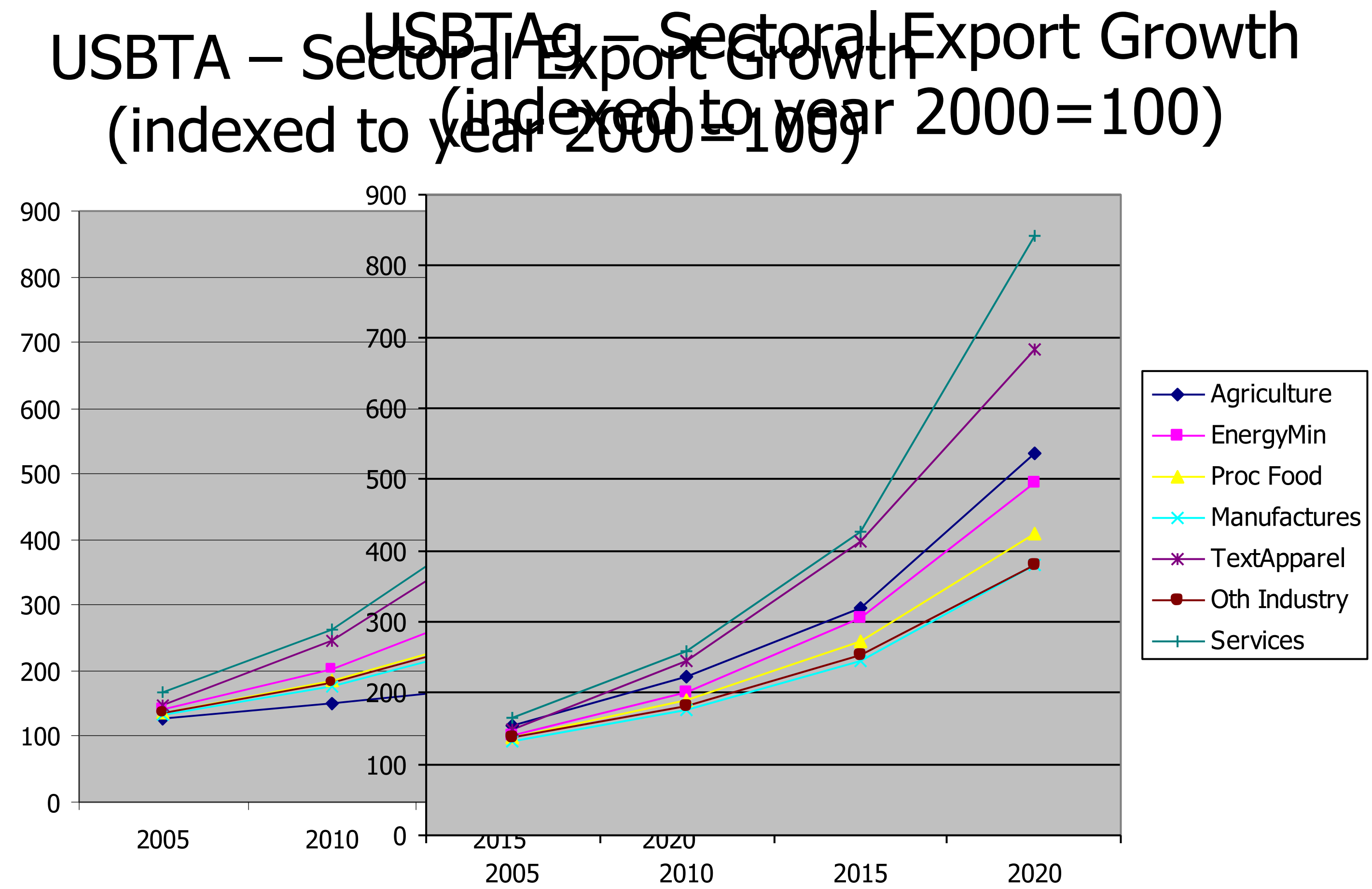
USBTA – Sectoral Output (billions of 2000 Dong)



nearly as fast as lower wage Services, and Textiles and Apparel have fallen to fourth place behind Construction. The economic forecasting model unfortunately does not capture the productivity gains of this more rapid expansion in infrastructure, but we know this makes an essential contribution to dynamic growth in all developing countries. Closer inspection of the trend lines in these three scenarios also reveals that, under FDI, output expansion is not only greater by 2020, but accelerating faster. This is consistent with the argument that human and nonhuman capital accumulation is the accelerator behind dynamic Asian growth.

The next three figures show how the composition of exports changes under the same three scenarios, revealing the role of external demand in the macro and domestic output results. In the first diagram, the low-wage trap is very obvious. Vietnamese export expansion is dominated by Textiles and Apparel under the passive liberalization regime of WTO+Reform. Of course, we only mean passivity with respect to external markets in this case, since the scenario calls for determined domestic reform. Ironically, however, this approach appears to confer most of the benefits of domestic reform on foreigners, with Vietnam facilitating low-wage exports and asking relatively little in return. To put it another way, the effort to reform internally cannot be fully rewarded without external reform and, conversely, external reform efforts, like WTO accession, cannot be fully rewarded without commitment to complementary domestic reforms.

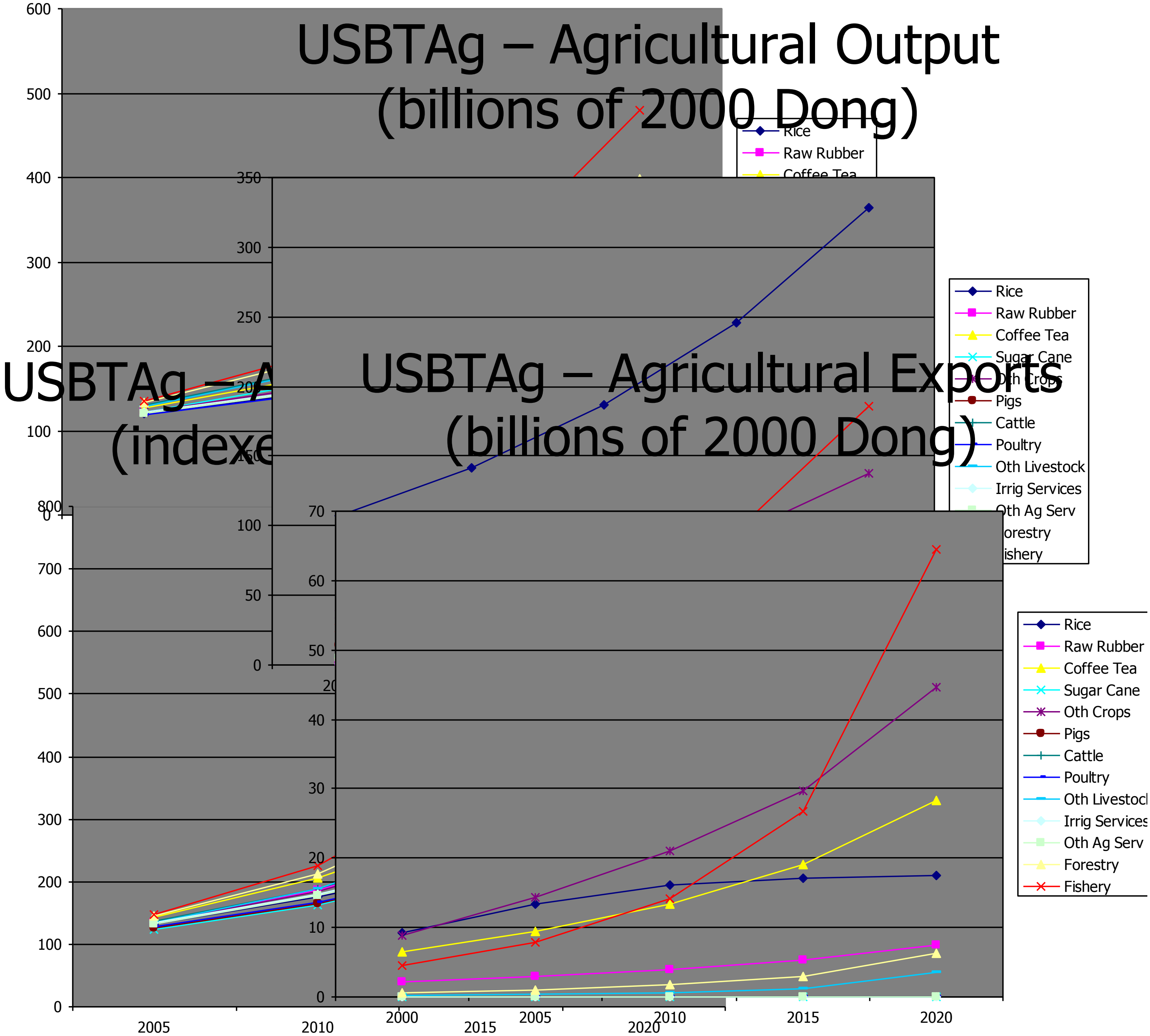
When actively negotiated bilateral trade materializes, this helps to diversify export composition significantly, but it is only when access to foreign capital improves that the fuller benefits of more dynamic and diverse exports can be realized. Vietnam can negotiate any market concessions that are politically feasible, but the reality of the economy's response will depend on the ability of the private sector to meet this external demand with internationally competitive quality and prices. This requires significant capital, from any source, but it brings with it domestic output and employment growth, technology assimilation and diffusion, and higher labor productivity/wages for Vietnamese workers.



USBTA – Agricultural Output Growth (indexed to year 2000=100)

USBTAg – Agricultural Output (billions of 2000 Dong)

USBTAg – Agricultural Exports (billions of 2000 Dong)



Related Policy Issues and Negotiating Agendas

In addition to the trade policy scenarios discussed in the previous section, Vietnam is facing important trade negotiating agendas in other areas. Below we summarize at few of these and give indications of how the current methodology can contribute to better policy formation and dialogue in these areas.

Agricultural Market Access

Agriculture, including Fishery, has the potential to be one of the most important export activities for Vietnam over the medium term. Because of current capital and technology constraints, the country has enormous unrealized agricultural potential, and the employment and income linkages from this sector dominate the economy. While the urban and non-agricultural sector of the economy is modernizing and developing capacity for more diversified production, trade, and employment, new market opportunities in agriculture can provide an essential source of rising income and new domestic savings.

For this reason, Vietnam's trade negotiators should redouble efforts to exploit Doha's emphasis on OECD agricultural market access. The potential agricultural demand from the US, EU, and Japan could lead to rapid and sustained increases in Vietnamese exports. Also, on current growth trends, there is strong evidence that China will become a large and sustaining food importer, and this will represent a new and very significant export opportunity for Vietnam.

Intellectual Property: IT and Pharmaceuticals

The next round of WTO group negotiations will re-define conformity standards in two important TRIPS areas, pharmaceuticals and information technology (esp. software). These revisions are intended to facilitate public health security and technology diffusion in developing countries, and Vietnam should be certain to take full advantage of these. In particular, as the standards emerge, Vietnam may want to re-examine and even re-negotiate elements of some BTAs that may be out of conformity with WTO exemptions in this area.

Four WTO Priorities for Advancing Trade Opportunities in Developing Countries

In recent public statements, the secretariat of the WTO has emphasized that the success of the Doha Round will be measured by its ultimate impact on developing countries. In order for those countries to realize the fullest benefits from external sources, the WTO is advocating emphasis on four aspects of policy. Each of these priority areas should be seen as an opportunity for dialogue between Vietnam and the WTO Secretariat. Each area also has important implications for domestic reform and implies important coordination issues with respect to other ministries.

Trade and Investment

Given the general scarcity of domestic capital, Foreign Direct Investment (FDI) has an essential role to play in Vietnam's domestic growth and trade expansion. FDI will be critically needed to expand production capacity and diversify the range of economic activities to which domestic resources can be committed.

As we saw in the scenario analysis above, attracting FDI is an essential responsibility for the government and this can be facilitated by official recognition of its efforts by multilaterals like the WTO and World Bank. To facilitate this, the government should pursue a coordinated policy approach with the principal line ministries (Finance, Central Bank, Planning and Investment, Trade).

The same external trade coordinating group may want to review Vietnam’s real and potential linkages to regional capital markets, including especially Singapore, HK, Shanghai, and Tokyo. The highest priorities here are to build visibility, facilitate information flow, and achieve conformity with regional standards for financial competitiveness.

Trade and Competition

The Trade and Competition component of WTO policy toward the Doha Round is intended to explicitly account for the linkages between external and domestic economic reform. It has already been made clear how important this consideration is for accelerating and sustaining Vietnamese growth, so it would be advisable for the Vietnamese negotiators to participate actively in dialogue with the WTO Secretariat on this issue.

Transparency in Government Procurement

Standards for government procurement and their dissemination are a high priority for the next round. This emphasis can be justified by the prominence and exemplary nature of public contracts and spending within any economy, but it is of particular significance in an economy like Vietnam’s, where the state has an unusually large and rapidly evolving role in the economy. Standards of this kind, applied to State Owned Enterprises, could be very beneficial to the climate for foreign investment and international competitiveness.

Trade Facilitation

In recognition of the constraints faced by some developing country WTO negotiating parties, the WTO has committed resources (currently about US$10 million) to developing trade negotiating capacity. Although Vietnam is fortunate to have well educated and experienced negotiators, it would probably be advisable to take advantage of these resources to upgrade capacity and sharpen perceptions of international negotiating standards.

Bilateral agreements with OECD counties

After the WTO and US BTA, the highest priority for trade negotiations should be given to bilateral talks with strategically important OECD countries. These countries represent about 80% of global trade and set the standards for multilateralism generally. Agreements of this kind will not only determine an important share of Vietnam’s trade opportunities over the medium term (during WTO implementation), but can actually facilitate WTO accession and downstream bilateral and regional negotiations.

Among the highest priority countries for bilateral talks are the members of the strategic WTO Working Group (WG). Many expert observers believe that enlarging and intensifying the bilateral process with these partners would be directly beneficial to Vietnam’s trade opportunities and progress in domestic reform, but can also indirectly expedite to WTO accession. Beginning with the EU, therefore, we recommend that Vietnam move quickly to more direct and deeper bilateral negotiations with WG members. Ideally, this group would be engaged over the next twelve months in order to facilitate the prospects for WTO accession as soon as possible.

Negotiations at this level (and the others discussed below) can be framed over an approximate ten-year time horizon. This is the period where one can expect reasonable divergence between bilateral agreements and WTO conformity. Thus, it is of most interest to the individual partners because they can negotiate differential concessions using selective phase-outs. Taking initiative for such bilateral talks also permits Vietnam to negotiate differential concessions, taking best advantage of each bilateral relationship without contradicting (eventual) WTO conditions.

EU-Vietnam

After the US, this is probably the most important BTA to be negotiated before accession. A classic North-South arrangement with significant economic diversity and large potential gains from specialization, this BTA can save enormous effort over negotiating with EU members individually. It will serve, however, to establish precedence that can expedite such bilateral bargaining when it is necessary.

Korea-Vietnam

Korea is the influential Chair of Vietnam's WTO Working Group. This fact alone would justify individual trade negotiations, but Korea also undoubtedly sees Vietnam as a potential East-Asian competitor, with whom sector-specific issues must be reconciled bilaterally. This is probably the most important outstanding bilateral deal to facilitate the WTO accession process for Vietnam.

Japan-Vietnam

Japan is the biggest economic player in the region, and an individual economic understanding with Japan is essential to correct positioning in East Asian trade patterns. It is also necessary to take full advantage of this country's enormous foreign investment and bilateral assistance potential. Particularly important will be implications for Vietnam of Japan's macro situation.

Bilateral Trade Agreements with Prominent non-OECD Partners

These agreements are essential to complete the diversification of Vietnam's medium term trade relations and to buttress its opportunities for growth by fuller and more collaborative participation in the greater Asian regional economy. Despite the heavy strategic emphasis on OECD negotiations, intra-regional trade is running at about 40% of total trade for Asia and growing significantly faster. In addition to those below, bilateral talks with India, Indonesia, and Singapore should be considered.

China-Vietnam BTA

A China-Vietnam BTA is probably the most critical long-term agreement outside US-EU-Japan. It is essential for sustainable growth in both countries and stability in the region that opportunities for economic complementarity between these two potentially strong rivals be identified and developed with direct negotiations. Vietnam's prospects as a supplier of two essential and growing Chinese imports, food and fuel, can provide the axis for cooperation in a China-Vietnam BTA.

Vietnam in ASEAN

With intra-regional trade running at 47% of total East Asia trade, evolving patterns of trade with ASEAN are a significant issue in Vietnam's overall trade and growth horizon. How will Vietnam's regional emergence affect other partners, where will it fit into the region's activity matrix and value-added ladders, and what is regional absorptive capacity for Vietnamese exports? It is essential that policies to confront these economic uncertainties be supported by negotiation with regional partners.

Trade Composition

Vietnam's current trade patterns are a reflection of its early stages of modernization and global market participation. As we have seen in the analysis above, external opening can increase trade, but may not alleviate excessive specialization unless what we termed passive tariff liberalization is combined with more strategic policies, such as capital market erforms and negotiated market access. To better understand these priorities, we take a closer look at trade composition for Vietnam and some of its individual and group trading partners. Consider the next diagram, which shows Vietnamese import shares to 2020. Here we see too much long term import dependence in manufactures and, especially, energy. Under a more balanced growth process, both these sectors would expand domestic capacity, developed in response to foreign investment and technology transfer incentives to satisfy the growing domestic market. Vietnam's energy sector, in particular, exhibits potential so great that Vietnam could, with the right investment partnerships, become a net exported in this sector. While the protectionist approach to import substitution has generally been discredited, a more activist approach to globalization can yield similar domestic capacity growth without the adverse effects of economic isolation.

To overcome excessive specialization, we have seen that two policy areas in particular need to be emphasized: Foreign and Investment and Parallel Negotiations. Foreign Direct Investment will be essential to expand, diversify, and modernize Vietnamese production capacity, for both the domestic and external market. Parallel negotiation with more prominent trading partners can develop demand for greater and more diversified Vietnamese exports, and will also improve conditions for bilateral investment flows.

In this context, the next two diagrams show direction of trade estimates for 2020 from the WTO+Reform scenario of the forecasting model. These represent exports and imports, disaggregated by destination and origin, respectively. Again it is apparent that, in the absence of complementary investment and market access policies, Vietnam will remain outside the mainstream of the ASEAN regional economy. This economic marginalization will probably include chronically low average wages, substandard capital formation and infrastructure development, and lagging technological development.

Exports by Destination

Imports by origin

Priority Issues

1) Tariff/Quota Policies and Negotiating Strategies

2) International Competitiveness at the Sector Level

3) Projections of SPS related Market Growth

4) Export Promotion and Producer Subsidies

5) Phase-out Strategies for Import Protection and other Domestic Producer Assistance

6) Rural Adjustment Assistance Policies

7) Rural Poverty Impacts and Alleviation

8) Negotiated Market Access

9) NTBs and other Agriculture Related Price Distortions

10) Economic Growth and Domestic Agriculture Demand Patterns.

Scope for Trade-based Economic Expansion

Vietnam is already committed to WTO accession, but for a country deeply involved in domestic economic reform, it might be reasonable to ask whether energy devoted to external liberalization should be a high priority activity. This question can be easily answered by reference to other East Asian, and particularly ASEAN experience. Those countries that not only liberalized trade externally, but strongly informed their domestic reform agendas from external market precedents, have seen dramatic and sustained improvements in material living standards. It is also worth emphasizing that the nature of the commitment to economic reform was a much more essential determinant of these economic improvements than the underlying political system. Each of the dynamic Asian stories had a strong and relatively decisive central government, but their underlying political norms varied considerably.

To give a more tangible sense of the real and potential importance of trade to ASEAN economies, and what this infers about Vietnam, the last diagram contrasts Vietnam's GDP, Total Exports, and Population with that of other ASEAN partners in the 2000 base year of the model. It is readily apparent from this that Vietnam is far from its potential, both in terms of total economic activity and participation in the world economy. That trade can make a dramatic contribution is obvious from the case of Singapore, which is tiny in terms of regional population but huge in terms of trade and GDP.

Pie charts

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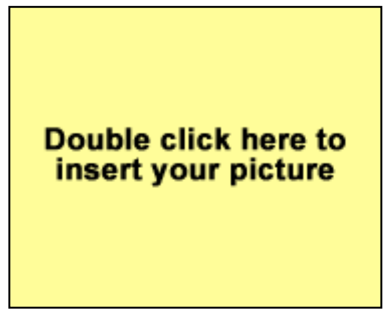

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