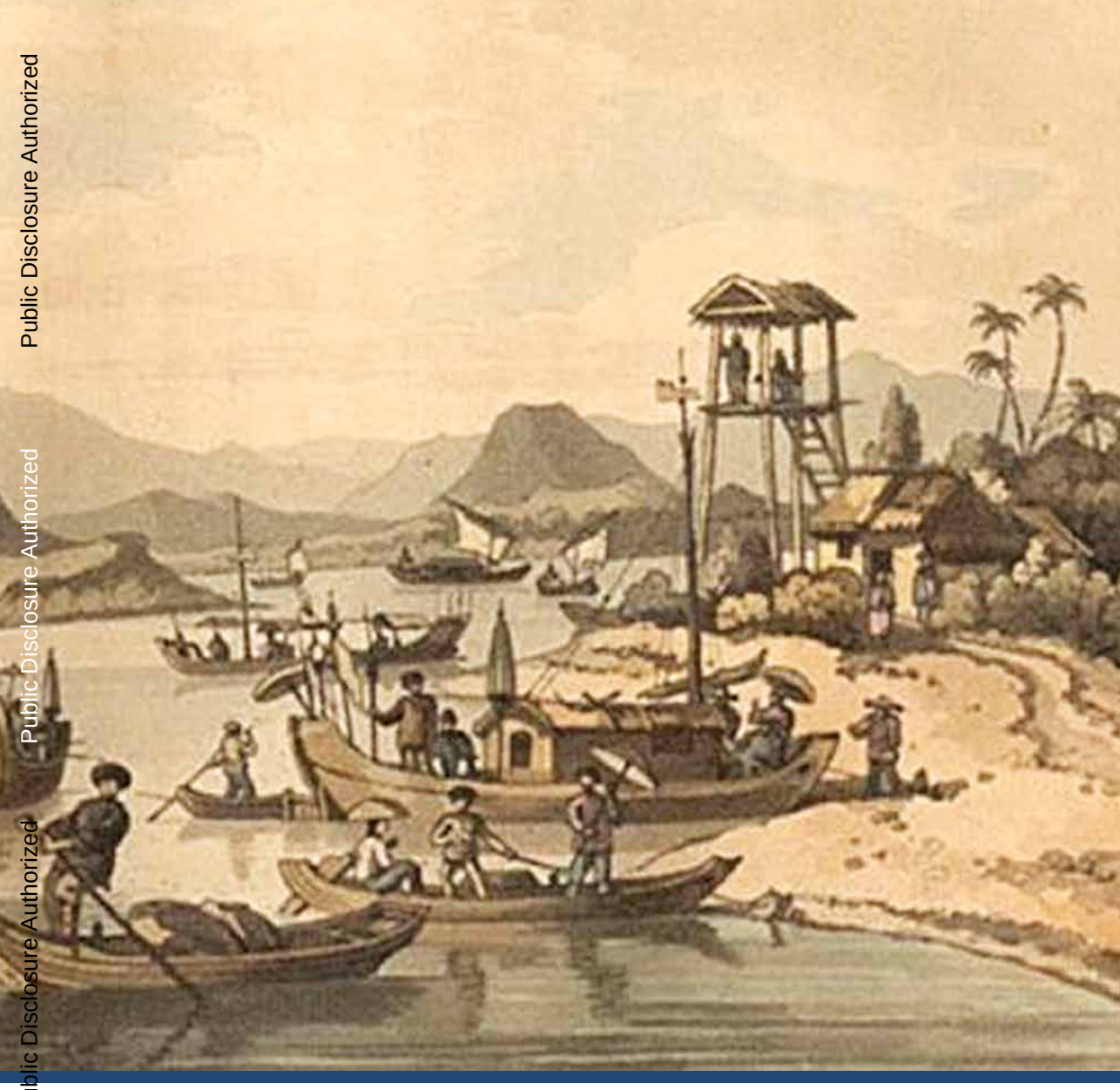

VIETNAM: DEEPENING INTERNATIONAL INTEGRATION AND IMPLEMENTING THE EVFTA

May 2020

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1818 H Street NW, Washington DC 20433

Telephone: 202-473-1000; Internet: www.worldbank.org

Cover print: The estuary of Faifo River flowing to Turon Bay in late 18th century.

Source: John Barrow. "A voyage to Cochinchina in the years 1792 and 1793". Chapter XVIII, 447 p. London. 1806.

The annexed cover print depicts foreign merchants in the 18th century travelling on Faifo River, which runs into Turon Bay. Faifo and Turon, now known as Hoi An Town and Da Nang City, were named by Europeans upon their arrival in Vietnam. The painting reflects Vietnam's openness to foreign trade since the early days.

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Foreword

Following from Vietnam's ratification of the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) in late 2018 and its effectiveness from January 2019, and the European Parliament's recent approval of the European Union-Vietnam Free Trade Agreement (EVFTA) and its subsequent planned ratification by the National Assembly in May 2020, Vietnam has further demonstrated its determination to be a modern, competitive, open economy. As the COVID-19 crisis has clearly shown, diversified markets and supply chains will be key in the future global context to managing the risk of disruptions in trade and in supply chains due to changing trade relationships, climate change, natural disasters, and disease outbreaks. In those regards, Vietnam is in a stronger position than most countries in the region.

The benefits of globalization are increasingly being debated and questioned. However, in the case of Vietnam, the benefits have been clear in terms of high and consistent economic growth and a large reduction in poverty levels. As Vietnam moves to ratify and implement a new generation of free trade agreements (FTAs), such as the CPTPP and EVFTA, it is important to clearly demonstrate, in a transparent manner, the economic gains and distributional impacts (such as sectoral and poverty) from joining these FTAs. In the meantime, it is crucial to highlight the legal gaps that must be addressed to ensure that national laws and regulations are in compliance with Vietnam's obligations under these FTAs. Readiness to implement this new generation of FTAs at both the national and subnational level is important to ensure that the country maximizes the full economic benefits in terms of trade and investment.

This report, "Vietnam: Deepening International Integration and Implementing the EVFTA," explores the issues of globalization and the integration of Vietnam into the global economy, particularly through implementation of the EVFTA. We would like to thank the key government stakeholders that have contributed to the report, which include the Ministry of Industry and Trade, the Ministry of Planning and Investment, and the Ministry of Justice. We are grateful to the World Bank's Umbrella Trust Fund for Trade for funding the report.

Tran Tuan Anh
Minister
Ministry of Industry and Trade

Ousmane Dione
Country Director
The World Bank in Vietnam

Acknowledgments

This report was prepared by a World Bank team comprising Duc Minh Pham (Senior Economist), Brian Mtonya (Senior Economist), Maryla Maliszewska (Senior Economist), Israel Osorio-Rodarte (Senior Economist), Maria Filipa Seara e Pereira (Senior Economist), and Dongwook Chon (Senior Economist), with contributions from Jacques Morisset (Lead Economist), Zoryana Olekseyuk (Senior Economist), Nguyen Thi Xuan Thuy (Consultant), and Pham Hong Van (Private Sector Development Specialist).

The report was prepared under the general guidance of Ousmane Dionne (Country Director for Vietnam), Hassan Zaman (Regional Director; Equitable Growth, Finance and Institutions; East Asia Pacific Region), and Deepak Mishra (Practice Manager; Macroeconomics, Trade and Investment; East Asia Pacific Region). Peer reviewers were Richard Record (Lead Economist), Massimiliano Cali (Senior Economist), Mr. Luong Hoang Thai, Director General, Department of Multilateral Trade Policy, Ministry of Industry and Trade; and Mr. Tran Toan Thang (Head of Trade Unit, National Center for Information and Forecasts, Ministry of Planning and Investment). Comments were also received from Viet Tuan Dinh (Senior Economist). Diane Stamm edited the report, Le Thi Khanh Linh provided administrative assistance, and Ngan Hong Nguyen and Anh Thi Quynh Le provided communication support.

Abbreviations

ASEAN	Association of Southeast Asian Nations
CGE model	computable general equilibrium model
COVID-19	Coronavirus disease
CPTPP	Comprehensive and Progressive Agreement for Trans-Pacific Partnership
EVFTA	European Union-Vietnam Free Trade Agreement
EVIPA	Investment Protection Agreement
FDI	foreign direct investment
FTAP	Free Trade Agreement Portal
FTAs	free trade agreements
GDP	gross domestic product
GIDD	Global Income Distribution Dynamics
GVCs	global value chains
ICT	information and communications technology
ILO	International Labor Organization
LPI	Logistics Performance Index
NTMs	non-tariff measures
OECD	Organization for Economic Co-operation and Development
PPP	purchasing power parity
QI	quality infrastructure
SIRM	Systemic Investment Response Mechanism
SMEs	small and medium-sized enterprises
SOEs	state-owned enterprises
SPS	sanitary and phytosanitary
TiVA database	WTO Trade in Value-Added database
TPP	Trans-Pacific Partnership
UNECE	United Nations Economic Commission for Europe
UNESCAP	United Nations Economic and Social Commission for Asia and the Pacific
Vietnam SPS	Vietnam Sanitary and Phyto-sanitary Notification Authority and Enquiry Point
WTO	World Trade Organization

Country codes

ARG	Argentina	NGA	Nigeria
BGD	Bangladesh	NIC	Nicaragua
BN	Brunei	PAK	Pakistan
BRA	Brazil	PER	Peru
CHN	China	PHL	Philippines
COL	Colombia	POL	Poland
DEU	Germany	PSE	Palestinian Territory
EGY	Egypt	RUS	Russia
FRA	France	SEN	Senegal
GBR	United Kingdom	SLV	El Salvador
GHA	Ghana	THA	Thailand
GRC	Greece	TUN	Tunisia
IDN	Indonesia	TUR	Turkey
IND	India	TZA	Tanzania
ISR	Israel	UGA	Uganda
JOR	Jordan	UKR	Ukraine
JPN	Japan	USA	United States
KEN	Kenya	VEN	Venezuela
KOR	Korea	VNM	Vietnam
MEX	Mexico	VTN	Vietnam
MMR	Myanmar	WLD	World
MYS	Malaysia	ZAF	South Africa

EXECUTIVE SUMMARY

Global integration has been one of the key drivers of Vietnam's remarkable achievements in growth and poverty reduction over the past three decades, in tandem with the Doi Moi reforms. Vietnam has benefited not only from rapid growth in and diversification of exports, but also from the technology embodied in trade. Trade openness continues to be viewed as beneficial in Vietnam, despite trends of deglobalization and rising trade tensions. Following the implementation of the Comprehensive and Progressive Trans-Pacific Partnership (CPTPP), Vietnam is preparing to implement the Vietnam Free Trade Agreement (EVFTA).

The EVFTA is the largest new-generation free trade agreement in the country's history in terms of direct benefits for Vietnam. Its gross domestic product (GDP) impact is almost three times larger than that of the CPTPP. The European Union (EU) is one of Vietnam's most important and stable trading partners. Vietnam's exports to the EU have steadily grown at an average annual rate of 16 percent, and Vietnam has gained a trade surplus with the EU over the past two decades. Implementing the EVFTA will help improve bilateral trade with the EU, sustain strong trade performance, and support strengthening Vietnam's key global value chains, among other things. More importantly, crucial changes in the economic structure and institutions as a result of implementation of the EVFTA and CPTPP will assist in deepening domestic reforms and help Vietnam become a more competitive and innovative economy.

The EVFTA will bring significant immediate benefits to the Vietnamese economy through higher growth, greater trade, and faster poverty reduction. Full implementation of the EVFTA could increase Vietnam's GDP by 2.4 percent, boost exports by 12 percent, and lift an additional 0.1 million to 0.8 million people out of poverty by 2030. It will also potentially help close the gender wage gap by 0.15 percentage points, particularly for households in the bottom 40 percent of income distribution. Further, if Vietnam simultaneously implements the EVFTA and CPTPP, its GDP could increase by up to 3.2 percent in the next decade. In addition to implementing trade agreements, if Vietnam adopts complementary domestic reforms to raise productivity, its GDP could increase further by 6.8 percent by 2030—4 percentage points more than the income gains from the EVFTA alone.

The EVFTA coupled with the CPTPP could strongly motivate and accelerate domestic reforms that go beyond the scope of the "trade" issues in the agreements. Among other things, the EVFTA will help promote competition, cooperation, and capacity building; and stimulate the development of services, including financial

services, telecommunications, and temporary entry of service providers, such as customs, logistics, and e-commerce. Many EVFTA provisions will also stimulate institutional reforms to strengthen and standardize rules, promote transparency, and support the creation of modern institutions in Vietnam, especially in areas of the environment, government procurement, intellectual property, investment, labor standards, legal issues, rules of origin, and non-tariff measures. Of particular importance for Vietnam, the state-owned enterprise (SOE) provisions under the CPTPP and EVFTA are expected to support structural adjustments in Vietnam toward a fair and balanced market-based economy and a level playing field.

Deeper integration would help Vietnam better cope with and recover more quickly from global shocks such as the current COVID-19 pandemic. The World Bank's April 2020 *East Asia and Pacific Economic Update* projected that Vietnam, given its stronger resilience, is among the few countries that could experience a positive growth rate in all scenarios, though lower than in 2019. This is a good reason for Vietnam to continue an open trade policy in response to the pandemic and to avoid future trade tensions. Thus, the full implementation of deep trade agreements such as the EVFTA could help boost production, trade, and investment, and thus facilitate a faster recovery in Vietnam in the post-COVID-19 era. The EU market appears to be one of the most affected by the COVID-19 pandemic, and demand will recover slowly. This prospect could hamper the EVFTA's positive impacts in the short term. This is shown by the fact that the growth of Vietnam's merchandise exports to the EU-28 for the first quarter of 2020 declined 5.1 percent (year-on-year).

The legal gap assessment that has been conducted as part of this report is expected to support the Vietnam National Assembly's ratification of the EVFTA in its upcoming session in May 2020, and will inform government agencies' preparation of a clear roadmap for its implementation. The EVFTA legal gap assessment shows that Vietnam's domestic laws are mostly in compliance with its obligations under the EVFTA and that the country is ready to implement the agreement. There are a few laws and regulations that need to be addressed, and these have been clearly identified in the legal gap assessment for revision. Vietnam has benefited from the CPTPP ratification process and revision of domestic laws, as most of the EVFTA provisions are compatible with those of the CPTPP. However, there are some commitment levels that are wider and higher than any other FTAs that Vietnam has signed, including with the World Trade Organization and the Association of Southeast Asian Nations (ASEAN).

Delivering global integration commitments, particularly under the EVFTA, means implementing a comprehensive and decisive domestic reform program, which is a challenging process. Given the limited length of this report, four key challenges were

chosen for discussion. First, the challenge dealing with rules of origin is reflected in the strict thresholds in terms of both minimum domestic origin and maximum non-EU originating materials (among other things) that Vietnam's exports will need to meet in order to enjoy the EU preferential tariff schedule. Second, Vietnam's exports, especially agricultural products, will be required to meet high quality and rigorous *sanitary and phytosanitary standards.* This is critical for an economy like Vietnam, where agriculture plays a significant role. Third, the EVFTA will boost foreign direct investment (FDI); however, a key challenge facing Vietnam is to manage an increasing number of commercial grievances caused by *disputes between investors and the state* and to comply with investment protection articles regulated under the Investment Protection Agreement (EVIPA). Finally, the pandemic could have strong implications on policy responses if Vietnam wants to *take advantage of the EVFTA post-COVID-19*.

Complying with rules of origin and sanitary and phytosanitary (SPS) requirements is among the most challenging implementation issues in maximizing EVFTA benefits. Vietnam's simple manufacturing assembly engagement in global value chains and the high dependence of its key exports on imported materials, especially from non-EU members, is the main barrier preventing Vietnamese firms from taking full advantage of tariff reductions, and this situation will need to improve. Regulations for non-tariff measures (NTMs) in general and SPS measures, in particular, remain complicated, which makes NTM cost incidence in Vietnam higher than in most of other ASEAN countries—a factor limiting Vietnam's trade capacity in general, and potential gains from the EVFTA, in particular. Efforts should also be made to cope with increased flows of FDI as a result of EVFTA implementation. Among the key recommendations discussed in this report are an integrated approach to developing efficient transport corridors based on value-chain spatial structure, and applying more transparent and predictable border procedures and non-tariff measures, an improved logistics regulatory environment to facilitate a general reduction in trade costs, and introducing a more liberal stance on FDI and a systemic investment response mechanism.

Post-COVID-19 recovery efforts should be made in all export-oriented industries, but priority should be given to key sectors reported as recent top Vietnamese exports to the EU market in order to take advantage of EVFTA implementation. Firms are the principal agent in this effort, but the government should make it a priority to support exports to the EU market. Business associations should play a critical role in raising the awareness of firms about the benefits of the EVFTA and in providing legal guidance for taking advantage of the EVFTA.

Policy responses should address the COVID-19 consequences in a longer term, as well. In the longer term, the combined impacts of COVID-19 and trade tensions could lead to a deep restructuring of global value chains (GVCs). GVCs tends to be less dependent on some global production centers, such as China, paving a way for Vietnam to step in to fill supply chain gaps. Global supply chains could also be shorter, with a fewer number of countries engaging. For some circumstances under the increasing unilateralism and bilateralism, lead firms could to bring all or some of their suppliers back home or to bilaterally beneficial countries. This phenomenon might create unhealthy and more severe competition at the global level. GVC structure could change from less backward to more forward integration. Vietnam could maximize benefits and minimize risks from this process if it can best reposition the country in the post-COVID-19 era. This requires stronger and proactive policy responses so that Vietnam can build more sophisticated production capacity and increase exports toward more value-added and high-tech prioritization.

In the long term, trade facilitation is a game changer, and Vietnam should turn the COVID-19 challenges into an opportunity to stimulate appropriate reforms. Key policy actions are appropriate and include:

i. Applying risk-based management for managing volunteer compliance and shifting to post-clearance inspections

ii. Applying information technology in inspections of export and import goods and transits, ensuring uniform information connection between state management agencies (specialized inspection units and the General Department of Customs)

iii. Effectively implementing the National Single Window and the ASEAN Single Window

iv. Promoting transparency in all specialized inspection agencies by issuing a product list with Harmonized System (HS) codes assigned for specialized inspection goods

v. Reducing logistics costs by reducing toll fees and digitalizing their collection, rationalizing trade-related transport and logistics infrastructure toward better-connecting value chains, and promoting multimodality.

An effective mechanism to handle and supervise the implementation of appropriate formulated policies should be in place to improve interagency coordination for trade facilitation and global integration.

Chapter 1

VIETNAM, GLOBAL INTEGRATION, AND THE EVFTA[1]

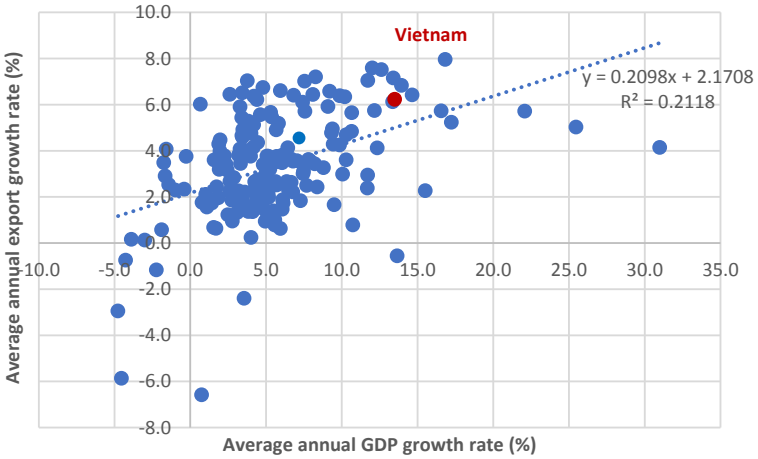
[1] This chapter was prepared by Duc Minh Pham.

Global integration has been one of the key drivers of Vietnam's remarkable achievements in growth and poverty reduction over the past three decades. Vietnam has benefited not only from rapid growth in exports, but also from the technology embodied in trade. Trade openness continues to be viewed as beneficial in Vietnam, despite trends of deglobalization and rising trade tensions. Following the implementation of the Comprehensive and Progressive Trans-Pacific Partnership (CPTPP), Vietnam is preparing to implement the Vietnam Free Trade Agreement (EVFTA), the largest new-generation free trade agreement in the country's history in terms of benefits for Vietnam. The European Union (EU) is one of Vietnam's most important and stable trading partners. Implementing the EVFTA will help improve bilateral trade with the EU, sustain strong trade performance, and support strengthening Vietnam's key global value chains, among other things. More importantly, crucial changes in the economic structure and institutions as a result of implementation of the EVFTA and CPTPP should deepen domestic reforms and help Vietnam become a more competitive and innovative economy.

1.1. Determination in international integration

Over the past three decades, Vietnam has evolved from being a fully closed economy to being one of the most open economies in the world. As a result of its global integration gains, Vietnam's ratio of trade to gross domestic product (GDP) exceeded 200 percent in 2018, among the highest of Association of Southeast Asian

Figure 1.1. **Export and GDP growth, 2000–18**

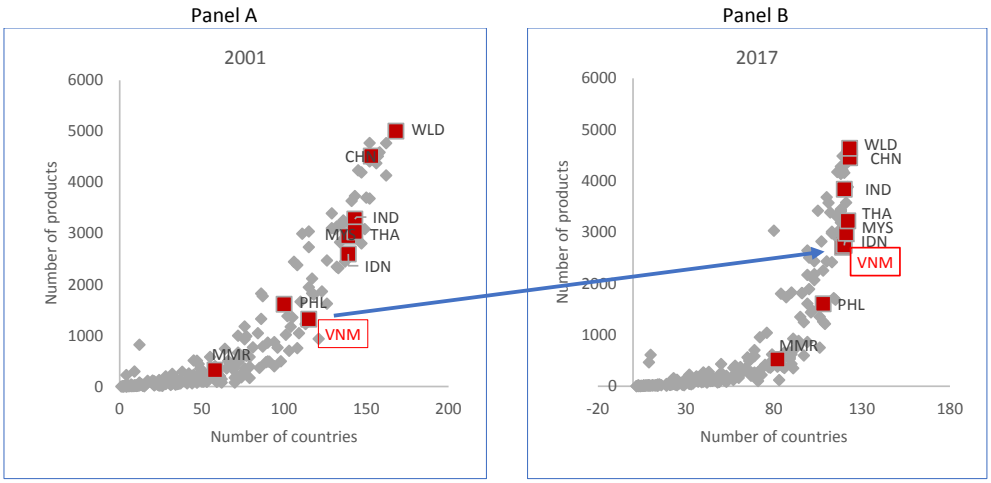


Source: World Development Indicators.

Nation (ASEAN) countries. Figure 1.1 displays the positive relationship of Vietnam's export and economic growth and shows that from 2000 to 2018, it was among the above-average performers. As a result of an export-led growth policy, Vietnam's GDP per capita has increased nearly fourfold from US$500 in 1992 to more than US$2,500 in 2018. The poverty rate, expressed as US$1.90 a day, improved markedly during the same period, decreasing from 52.9 percent to around 2.0 percent. In addition, manufactures, especially labor-intensive sectors such as textile and garment, footwear, food processing, and electronics, benefited from this expanded market access process, enabling Vietnam to increasingly participate in global value chains. This spectacular achievement resulted largely from trade liberalization underpinned by several free trade agreement (FTAs), in particular.

Stimulated by the progress in trade liberalization, Vietnam has been able to produce more products and engage more extensively with international markets. Figure 1.2 shows that the number of products Vietnam produced and markets it accessed increased considerably between 2001 and 2017 compared to peer countries. Over that period, Vietnam was able to increase the number and diversity of the products it produced so that by 2017, it was nearly on the same level as Indonesia, Malaysia, and Thailand in the ASEAN-4.[2]

Figure 1.2. **Number of products and markets, Vietnam and peer countries, 2001 compared to 2017**

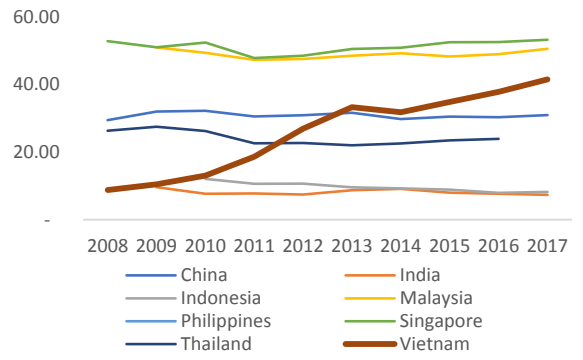


Source: World Development Indicators.

[2] The ASEAN-4 comprises Indonesia, Malaysia, the Philippines, and Thailand.

In the longer term, Vietnam benefits not only from export growth, but also from the improvement of the export structure, particularly in terms of the level of technology embodied in trade. Vietnam has done very well in this regard, especially over the last decade (figure 1.3). During that period, high technology exports as a percentage of manufactured goods exports increased significantly, from 8.7 percent in 2008 to 41.4 percent in 2017, a level comparable to China and higher than the ASEAN average. The speedy flows of high-tech foreign direct investment (FDI) led to a boom in the technology sector. High-tech FDI is considered to be a catalyst for Vietnam's growth and development, due to possible spillover effects through the faster transfer of know-how, innovation, productivity, and sophistication, factors also crucial for national competitiveness.

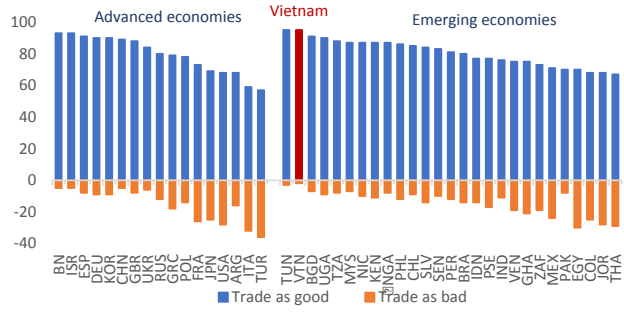
Figure 1.3. **High-tech exports as percentage of manufactured exports, 2008–17**



Source: World Development Indicators.

Trade is still viewed as beneficial in Vietnam, despite the diverging perceptions on the benefits of trade currently challenging globalization, and even in the context of recent increasing trade tensions (figure 1.4). Vietnam tends to adopt a two-way approach to whether tariff reduction is now reaching its limits, and to the slower pace of trade liberalization. On the one hand, it is focused more on reducing trade costs by minimizing non-tariff costs through improving trade facilitation.[3] On the other hand, Vietnam is determined to deepen global integration by joining a new generation of free trade agreements, including the Comprehensive and

Figure 1.4. **Diverging public views on trade**



Source: Pew Research Center, 2014.

[3] See Pham and Oh 2018.

Progressive Agreement for Trans-Pacific Partnership (CPTPP) and the European Union-Vietnam Free Trade Agreement (EVFTA). The objective is to use the commitments under these FTAs to stimulate difficult domestic reforms in many areas, especially to modernize institutions and make the economy more competitive. Vietnam has been implementing the CPTPP since November 2018, after its National Assembly ratified the deal. Vietnam is now ready to implement the EVFTA.

This report addresses the readiness of Vietnam to implement the EVFTA. The following sections of this chapter will highlight the background on the EVFTA and key issues of the trade relationship between Vietnam and the European Union as context for the report. Chapter 2 will provide a quantitative assessment of the economic gains from, and distributional impacts of, the EVFTA as the motivation for Vietnam's decision to join the agreement. Chapter 3 will assess the legal gaps for Vietnam's implementation of the EVFTA, reflecting a critical step for Vietnam's readiness to implement the deal. Chapter 4 will conclude with a discussion of key implementation issues of the EVFTA and other FTAs, including restrictive rules of origin and sanitary and phytosanitary issues, and the way Vietnam could enhance its capacity in these areas to maximize EVFTA tariff reduction, and the issues of investor rights for the implementation of the Investment Protection Agreement (EVIPA).

1.2. Background on the EVFTA

The EVFTA is the largest new-generation FTA in terms of benefits for Vietnam. Once the EVFTA comes into effect, the European Union[4] (EU) will eliminate import duties on about 85 percent of tariff lines, equivalent to 70.3 percent of Vietnam's exports to the EU. After seven years, the EU will eliminate import duties on 99.2 percent of tariff lines, equivalent to 99.7 percent of Vietnam's exports. For the remaining 0.3 percent of exports, the EU commits to giving Vietnam a tariff quota with an import duty of zero percent. For EU exports, Vietnam will eliminate tariffs as soon as the agreement comes into effect for 48.5 percent of tariff lines (accounting for 64.5 percent of total import value). After seven years, 91.8 percent of tariff lines equivalent to 97.1 percent of EU exports will be exempt from import taxes. After 10 years, tariffs will be eliminated on about 98.3 percent of the tariff lines (accounting for 99.8 percent of total import value). For the remaining 1.7 percent

[4] The EU-28 comprises Austria, Belgium, Bulgaria, Croatia, Cyprus, the Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Italy, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden, and the United Kingdom. The UK left the EU on January 31, 2020, but it has continued to adhere to EU trade policy during the transition period.

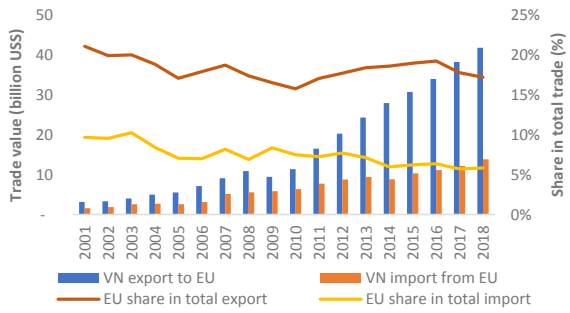
of EU tariff lines, Vietnam could apply tariff quotas in accordance with World Trade Organization (WTO) commitments. Vietnam also committed to facilitate EU investor investments in service sectors such as finance, telecommunications, transportation, and distributions. The EU and Vietnam also made commitments on the national treatment of investments, and the content of dispute resolution mechanisms between investors and the state. See box 1.1 for key milestones in the development of the EVFTA.

Box 1.1. The EVFTA: Key milestones

- October 2010: Vietnam's Prime Minister and the EU President agreed to launch EVFTA negotiations.
- June 2012: Vietnam's Minister of Industry and Trade and the EU Trade Commissioner announced the launch of EVFTA negotiations.
- December 2015: End of negotiations and start of legal review to prepare for the agreement signing.
- June 2017: Completion of legal review at the technical level.
- September 2017: The EU officially asked Vietnam to separate the content of investment protection and the dispute settlement mechanism (investor-state dispute solutions) between the state and investors from the EVFTA. Under this proposal, the EVFTA will be separated into two agreements: (a) the Free Trade Agreement, which covers all of the current EVFTA; and (b) the Investment Protection Agreement (IPA), which covers investment protection and investment dispute settlement. This Investment Protection Agreement must be ratified by both the European Parliament and Member States' Parliaments before it can be implemented.
- June 2018: Vietnam and the EU officially agreed to separate the EVFTA into two agreements: the Vietnam-European Union Free Trade Agreement (EVFTA) and the Investment Protection Agreement (EVIPA).
- August 2018: Legal review of the EVIPA completed.
- October 17, 2018: The European Commission officially adopted the EVFTA and EVIPA.
- June 25, 2019: Council of Europe approved for signature.
- June 30, 2019: Signing ceremony of the EVFTA and EVIPA in Hanoi.
- January 21, 2020: The International Trade Commission of the European Parliament voted in favor of ratifying the EVFTA.
- February 12, 2020: The European Parliament ratified the EVFTA and the EVIPA.
- Vietnam's National Assembly is expected to ratify the EVFTA and EVIPA in its coming session in May 2020.
- The EVTFA will come into force one month after formal ratification by the EU and Vietnam, while the EVIPA will require additional ratification by the parliaments of individual EU Member States.

1.3. Key issues in the trade relationship between Vietnam and the European Union

Figure 1.5. **Vietnam–EU: Stable trade relationship**

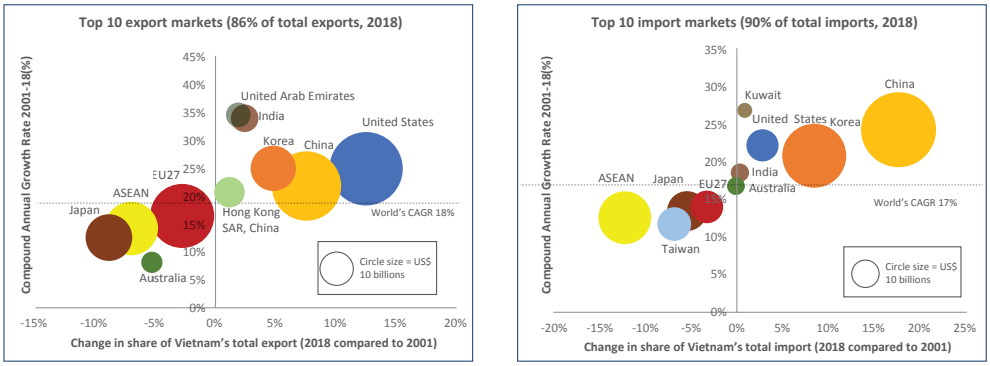


Source: Trade Map.

Trade relations between Vietnam and the EU have been stable for over three decades; indeed, the EU is one of Vietnam's most important trading partners. From 2001 to 2018, Vietnam's exports to the EU have steadily grown at an average annual rate of 16 percent (despite a slight decrease from 21 percent to 17 percent in the share of exports to the EU of Vietnam's total exports). Similarly, the annual growth rate of Vietnam's imports from the EU has been 14 percent on average despite a slight decline in the share of the EU's imports in Vietnam's total imports (from 10 percent in 2001 to 6 percent in 2018). The EU was the third-largest export market and the sixth-largest import market for Vietnam in 2018.

There is room to improve this bilateral trade relationship. As shown in figure 1.6, during the past two decades (2001–18) the growth of bilateral trade between Vietnam and the EU-27 has been below Vietnam's average trade growth rate (red bubbles for both exports and imports are below the horizontal axis), and the share of trade between Vietnam and the EU-27 in Vietnam's total trade has declined during the last two decades (the red bubbles for both exports and imports are in the left of the vertical axis). The EVFTA is expected to strengthen the bilateral trade performance (by moving the red bubbles—for both exports and imports—toward the upper and right-hand-side direction).

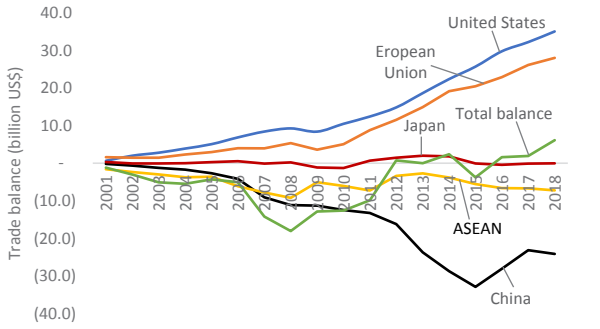
Figure 1.6. **Potential for improving bilateral trade performance**



Source: Trade Map. Note: CAGR = compound annual growth rate.

Vietnam has gained a trade surplus with the EU over the last two decades, which has compensated for an overall trade deficit with other trading partners. As shown in figure 1.7, during 2001–18, Vietnam gained increasing trade surpluses with the United States and the EU among its top five trading partners. This surplus compensates for trade deficits with China and the ASEAN countries, which have tended to be widening. That makes the overall trade balance relatively positive in recent years.

Figure 1.7. **Vietnam's trade balance with European Union**

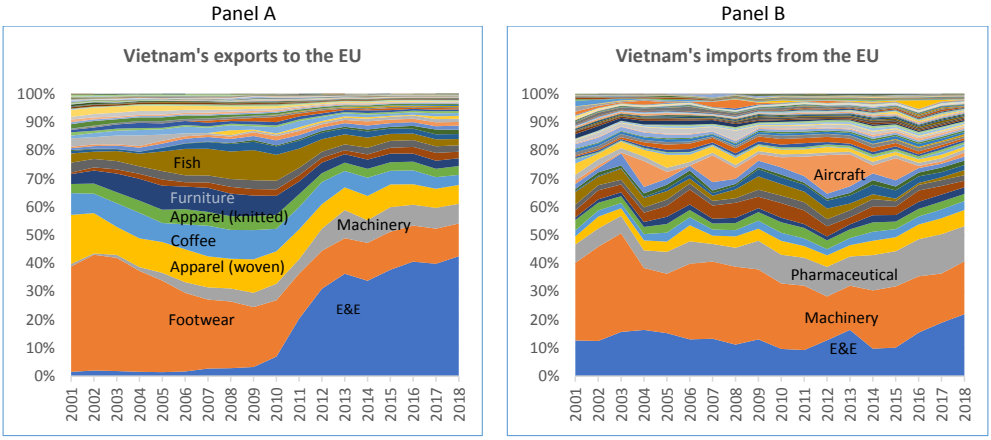


Source: Trade Map.

Bilateral trade between Vietnam and the EU tends to support strengthening Vietnam's key global value chains (GVCs). Vietnam's most popular exports include agricultural products (fish, coffee) and manufacturing (apparel, machinery, electronics and electrical equipment, furniture). These products fall mostly into two groups—consumer goods and capital goods. The increase in the share of the export of capital goods has derived from an increase in the export of electronics products. Vietnam's imports from the EU include electronics and electrical equipment,

machinery, pharmaceuticals, and aircraft. Imported capital products are mainly from electronics and electrical equipment, machinery, and pharmaceutical products. Other than a decline in the share of consumer goods, the sectoral structure of both Vietnam's exports to the EU and Vietnam's imports from the EU tended to support key manufacturing and agricultural value chains of Vietnam, as shown in figure 1.8.

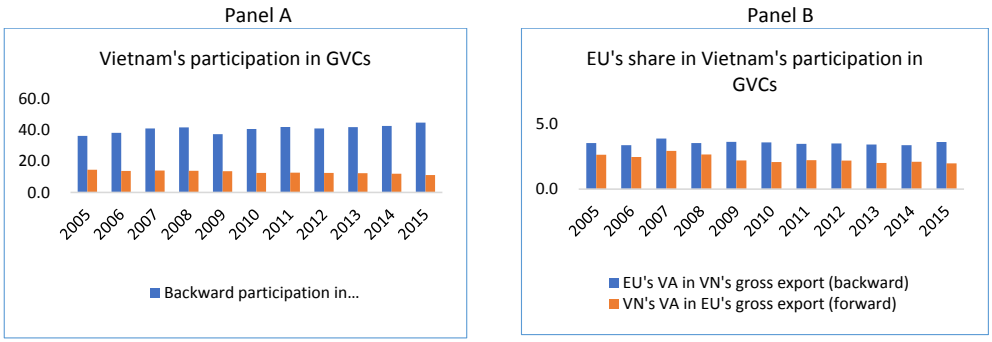
Figure 1.8. **Sectoral trade relationship**



Source: UN Comtrade.
Note: E&E = electronics and electrical equipment.

The EVFTA is expected to help improve Vietnam's participation in GVCs. Figure 1.9 compares Vietnam's value added in EU gross exports with that of global exports. Vietnam's links to GVCs mainly through backward links shows a slight increase, from about 36.1 percent in 2005 to 44.5 percent in 2015. This is not the case for forward links, which have declined from 14.5 percent to 11.1 percent during the same period. In the meantime, the current trade relationship with the EU has not played a significant role in supporting Vietnam's participation to GVCs. It is reflected by a small share of the EU's value added in Vietnam's gross exports (only 3.6 percent), and Vietnam's value added in the EU's gross exports (which decreased from 2.7 percent to 2.0 percent). An expectation of increased FDI flows to Vietnam, especially from investors coming from the Eurozone in order to take advantage of the EVFTA, would help improve this situation. Policy response to improve GVC integration and FDI increase will be further addressed in Chapter 4.

Figure 1.9. **Vietnam's value added (VA) as share of exports to the EU compared to the world**



Source: OECD.

1.4. Key benefits and risks of joining the EVFTA

The EVFTA is expected to bring several immediate benefits to Vietnam, as well as longer-term benefits from economic and institutional restructures. The direct impacts of the EVFTA on the growth of GDP and on exports and imports are more significant than that of any other FTA Vietnam has negotiated. This is because the room for tariff reduction given the current tariff schedules of both sides, coupled with the size of market that applied reduced tariff are far larger than any FTAs Vietnam has ever signed. Chapter 2 will quantify these direct benefits. The crucial changes in the current economic structure and institutions as a result of implementation of the EVFTA are expected to help put Vietnam on the right track to the creation of a more competitive and innovative economy.

The EVFTA coupled with the CPTPP could strongly motivate and accelerate domestic reforms that go beyond the scope of the "trade" issues in the agreement. Together with the implementation of the CPTPP, the EVFTA reflects the contents of modern trade agreements: promoting competition, cooperation, and capacity building; and stimulating the development of services, including financial services, telecommunications, and temporary entry of service providers, such as customs, logistics, and e-commerce. Many EVFTA provisions will also stimulate institutional reforms to strengthen and standardize rules, promote transparency, and support the creation of modern institutions in Vietnam, especially in areas of the environment, government procurement, intellectual property, investment, labor standards, legal issues, rules of origin, non-tariff measures including sanitary and phytosanitary and Technical Barriers to Trade measures, and trade remedies. Of particular importance

for Vietnam, the state-owned enterprise (SOE) provisions under the CPTPP and EVFTA agreements are expected to sustain structural adjustments in Vietnam toward a fair and balanced, market-based economy and a level playing field.

The EVFTA could support the creation of a more competitive and innovative economy. Over the longer term, it is not just the growth rate of exports that matters, but also the composition of exports, and in particular the level of technology they embody. Despite Vietnam's good performance in recent years in the growth of high-technology exports compared to peer countries including China and the ASEAN countries (see the above analysis), Vietnam's exports have remained primarily low-value goods. As mentioned, larger flows of quality foreign investments can be redirected to upstream supply chains and ancillary industries of beneficial sectors, such as textiles, apparel, and leather, to seize the EVFTA opportunities. This process will stimulate domestic private firms to participate in extended domestic supply chains and integrate into GVCs, which ultimately will further boost value-added exports.

Delivering global integration commitments, particularly under the EVFTA, means implementing a comprehensive and decisive domestic reform program, and this is a challenging process. The country's readiness to implement FTAs reflects its completion of a legal gaps assessment (see Chapter 3) and the availability of an implementation roadmap with sufficient supporting policy measures. Supervision of the implementation is vital for netting the EVFTA benefits.

1.5. The EVFTA in the context of COVID-19

Deeper integration would help Vietnam better cope with and recover quickly from global shocks such as the current COVID-19 pandemic. The World Bank's April 2020 East Asia and Pacific Economic Update projected that growth in the region is declining significantly in all scenarios, but Vietnam, given its stronger resilience, is among the few countries that could experience a positive growth rate in all scenarios, though lower than in 2019.[5] The report strongly advises all countries to sustain an open trade policy in response to the pandemic and avoid future trade tensions. The report provides an analysis of import targets, defining an element of the China-U.S. trade deal that aims at expanding the imports of a specified set of products over a certain period. In the context of deepening global integration, Vietnamese policy makers would benefit from this analysis by better defining whether the China-U.S. trade agreement based

[5] According to this report, Vietnam's growth would decline from 7.0 percent, as projected earlier, to 4.9 percent in the base case scenario, or to 1.5 percent in the lower case scenario.

on import targets prompts relief because it averts a damaging trade war, or creates concern because selective preferential access for the United States to China's markets breaks multilateral rules against discrimination (see box 1.2).

Box 1.2. The impact of the China-U.S. Trade Agreement

The China-U.S. Trade Agreement raised the concern that selective preferential access for the United States to China's markets would erode the multilateral rules against discrimination and divert trade from third countries in the region, costing them about one-third of a percentage point in GDP. Simulations from a computable general equilibrium model suggest that the United States and China would be better off under this "managed trade" agreement than if the trade war had escalated. However, compared with the policy status quo, the deal will make everyone worse off except the United States and its input-supplying neighbor, Mexico. Real incomes in the rest of the world would decline by 0.16 percent, in East Asia (excluding China) by 0.30 percent, and in China by 0.40 percent because of trade diversion.

China can reverse those losses if, instead of granting the United States privileged entry, it opens its market to all trading partners. Global income would be 0.60 percent higher than under the managed trade scenario, and China's income would be nearly 0.50 percent higher. Most developing countries in East Asia would be also better off, despite the partial erosion in their preferential access to the Chinese market. By creating a stronger incentive for China to open its markets to all, an exercise in bilateral mercantilism has the potential to become an instrument for multilateral liberalization.

Managed trade makes all developing East Asian countries except Cambodia worse off (figure B1.2.1). Achieving the import targets of the China-U.S. agreement through multilateral liberalization by China rather than managed trade would make all developing East Asian countries except Indonesia better off (figure B1.2.2).

Figure B1.2.1. **Impacts of the managed trade scenario compared to the trade policy status quo scenario for East Asian developing countries (percent)**

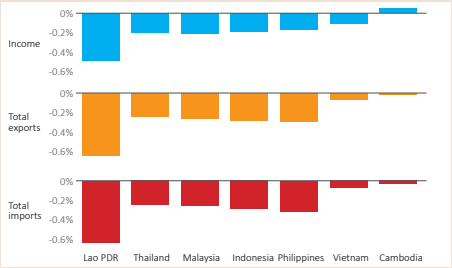
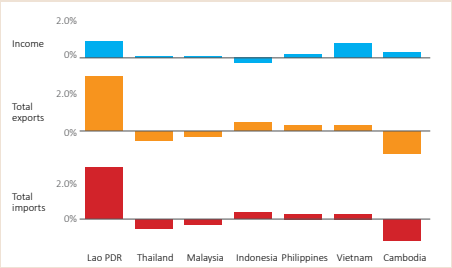


Figure B1.2.2. **Impact of the "multilateral liberalization" scenario compared to the "managed trade" scenario for East Asian developing countries (percent)**



Source: East Asia and Pacific Economic Update, World Bank, April 2020.

Instead of renegotiating the bilateral commitments, all countries would benefit if China opened its market to all trading partners. That would provide a much-needed boost of an estimated 0.6 percent to global income. China's income could be nearly 0.5 percent higher and most developing countries in East Asia would also be better off.

Source: Summarized from East Asia and Pacific Economic Update, World Bank Group, April 2020.

The full implementation of deep trade agreements such as the EVFTA could help boost production, trade, and investment, and thus facilitate a faster recovery in Vietnam in the post-COVID-19 era. However, the likely recession due to the pandemic would adversely affect global and EU markets, which could hamper the EVFTA's positive impacts in the short term. GDP growth in Europe is expected to decline by 3.18 percent. The EU zone appears to be one of the most affected economies due to the COVID-19 pandemic, according to the projection by the World Bank. It could recover slowly from the crisis according to a new projection from the European Commission, as shown in box 1.3, resulting in a slower pace of demand recovery for Vietnam's exports into this particular market. In fact, the growth of Vietnam's merchandise exports to the EU-28 for the first quarter of 2020 declined 5.1 percent (year-on-year). Chapter 4 discusses key policy measures to take advantage of the EVFTA after COVID-19.

Box 1.3. COVID-19 impact on the EU market

The February 13, 2020, Winter Economic Forecast released the interim projection, based on the limited data available at that time, that GDP growth in 2020 and 2021 would be subdued in the EU and the euro area at 1.4% and 1.2%, respectively, on the assumption that the 2019 novel coronavirus spread-out would have limited global spillovers. The European Commission released a new estimate on March 13, 2020, on the pandemic's significant detrimental economic impact on the EU and euro area. It assumed the key transmission channels included (i) the shock resulting from China's initial contraction in the first quarter of 2020; (ii) the supply shock to the European and global economy resulting from the disruption of supply chains and absences from the workplace; (iii) a demand shock to the European and global economy caused by lower consumer demand and the negative impact of uncertainty on investment plans, and (iv) and the impact of liquidity constraints for firms.

The direct impact through all these channels is estimated to reduce real GDP growth in 2020 by 2.5 percentage points compared to if there were no pandemic. Given that real GDP growth was forecast to be 1.4% for the EU in 2020, this would imply it could fall to just over-1% of GDP in 2020, with a substantial but not complete rebound in 2021 (figures B1.3.1 and B1.3.2). The actual impact could be more serious, however, given the current speed of the pandemic and its likely impacts.

Figure B1.2.3. **Impact of COVID-19 on EU GDP growth in 2020, by transmission channels (percent)**

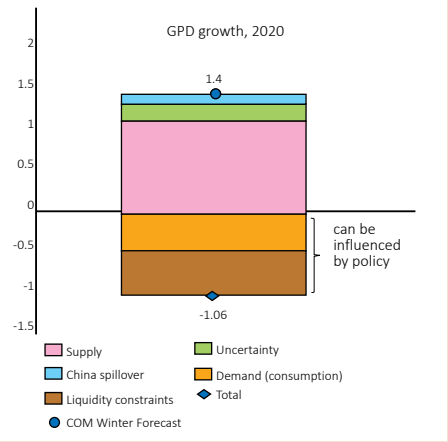
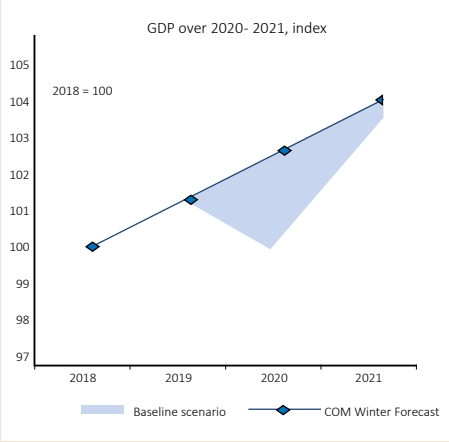


Figure B1.2.4. **Estimated impact of the COVID-19 pandemic on the EU economy by 2021**



Source: European Commission.

Chapter 2

ECONOMIC AND DISTRIBUTIONAL IMPACTS OF THE EVFTA[6]

[6] This chapter was prepared by Maria Filipa Seara e Pereira (ETIRI), Israel Osorio-Rodarte (ETIRI), and Maryla Maliszewska (ETIRI), with simulations prepared by Zoryana Olekseyuk (ETIRI).

The EVFTA will bring significant benefits to the Vietnamese economy through higher growth, greater trade, and faster poverty reduction. Full implementation of the EVFTA could increase Vietnam's GDP by 2.4 percent, boost exports by 12 percent, and lift an additional 0.1 million to 0.8 million people out of poverty by 2030. It will also potentially help close the gender wage gap by 0.15 percentage points, particularly for households in the bottom 40 percent of income distribution. Further, if Vietnam simultaneously implements the EVFTA and CPTPP, its GDP could increase by up to 3.2 percent in the next decade. In addition to implementing trade agreements, if Vietnam adopts complementary domestic reforms to raise productivity, its GDP could increase further by 6.8 percent by 2030—4 percentage points more than the income gains from the EVFTA alone.

2.1. Methodology

2.1.1. The Model

A top-down macro-micro modeling framework is applied to evaluate the economic and distributional impacts of the EVFTA. LINKAGE is a global dynamic computable general equilibrium (CGE) model. It allows the incorporation of complex interactions in a comprehensive economic modeling framework. For instance, the model reflects differences in productivity among countries, sectors, and factors of production; shifts consumer demand as income varies; and adjusts comparative advantage and trade flows due to trade liberalization. In finer detail, production is specified as a series of nested constant elasticity of substitution functions; the model uses a vintage structure of production that allows for semi-putty capital.[7] Demand is specified with each domestic agent at Armington level.[8]

A microsimulation model—Global Income Distribution Dynamics (GIDD)—is linked to the LINKAGE model, allowing us to measure the heterogenic nature of the impact of a free-trade agreement across different types of households and workers, offering a better understanding of the impacts of poverty and distributional effects in the Vietnamese economy. The microsimulation model will distribute the CGE macroeconomic results to households on top of Vietnam's Household Living Standards Survey (2012).

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[7] Semi-putty capital is new capital that is more mobile across sectors than old capital.

[8] The CGE closure rules used in this application are based on the following assumptions: (a) aggregate investment is savings-led, meaning that private savings rates are considered exogenous and private investment is considered endogenous; and (b) government expenditures, fiscal balance, and net capital flows are fixed as a proportion of GDP.

The two models operate mainly through the labor supply, skill formation, and real earnings. In terms of labor supply, the macro and micro models incorporate projections of the skilled and unskilled workers available over time. These projections are based on standard population projections and educational trends. The GIDD framework captures the reallocation of labor across sectors in a dynamic setting. On the earnings side, the GIDD incorporates the CGE-based simulated changes in skilled wage premia, income growth, and changes in relative prices for food and nonfood items.[9]

This study covers two scenarios: a baseline without FTAs (CPTPP and EFFTA), and with implementation of the EVFTA. The baseline functions as a representation of a reality where neither the CPTPP nor the EVFTA would have been implemented. The key macroeconomic indicators for the baseline follow the projections of the World Bank until 2018, and therefore include any FTAs already set to be implemented by 2030. The FTAs included are the same as the list of FTAs by the WTO, described in the International Trade Centre database. The baseline, therefore, will differ from the other scenarios in terms of market openness for Vietnam and the net effect of the reduction in tariffs and non-tariff barriers.

2.1.2. Caveats

The modeling framework focuses on tariff and non-tariff measure liberalization, including some productivity gains, but fails to capture deep FTA commitments, extensive margin in trade, or potential FDI inflows. While FTAs reduce barriers (tariffs and non-tariff barriers) for Vietnam in relation to other partners, and from other partners to Vietnam, the treaty also includes other noteworthy and ambitious provisions that the model is not able to fully capture. These provisions include intellectual property rights, investment liberalization, and sustainable development. The results of the model derived from lower barriers primarily show gains related to the impact of the reallocation of production to more productive sectors and countries. Trade openness also offers other potential gains for Vietnam; however, these factors are hard to quantify in a way that can be comprehensively modeled. For example, it is expected that Vietnam will be able to attract additional foreign investment and that trade reforms would create opportunities for entrepreneurs to jump into new markets or develop new products. But since these consequences are hard to account for, the model can only provide an estimation of the potential of gains with limited assumptions. To allay these difficulties, the EVFTA scenario will have an alternative version called the productivity kick, with higher productivity based on the calculation of the trade-weighted average barriers reduction. For a representation of

[9] Bourguignon and Bussolo 2013; Balistreri et al. 2018.

its potential effects, we assume that a 10 percent decrease in trade protection leads to 0.5 percentage points of productivity gains, following the results of Topalova and Khandelwal (2011).

2.1.3. Policy scenario

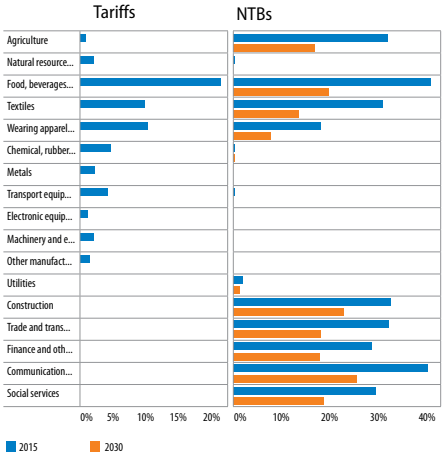
The EVFTA would lead to substantial liberalization of bilateral trade, with full elimination of tariffs and a halving of non-tariff measures. Almost full removal of tariffs is expected after implementation, including the elimination of over 99 percent of customs duties on exports for the Vietnamese and EU economies, as table 2.1 shows. Non-tariff barriers will also be reduced, with Vietnam aligning itself with international standards in sectors such as motor vehicles and pharmaceuticals. In addition, customs procedures will be simplified and standardized. EU products will require neither additional testing nor certification when entering the Vietnamese market. The implementation of tariff reductions in this scenario matches the agreed EVFTA tariff commitment schedule, which has implementation starting in 2020. Non-tariff-barrier reductions in goods and services are aligned with the results of Petri and Plummer (2016), starting in 2016, with 10 percent of maximal reduction, and eventually reaching 100 percent in 2025 (see figures 2.1 and 2.2).

Table 2.1. **Vietnamese and foreign tariffs and non-tariff measure ad-valorem equivalents (trade weighted) before and after EVFTA – for trading partners, (%)**

Tariff Scheme	2015	2030
Tariffs imposed by Vietnam on EU members, %	6.5	0.1
Tariffs faced by Vietnam in EU markets, %	6.1	<0.01
Non-tariff barriers imposed by Vietnam on FTA members, %	22.6	12.9
Non-tariff barriers faced by Vietnam in EU markets, %	16.9	8.5

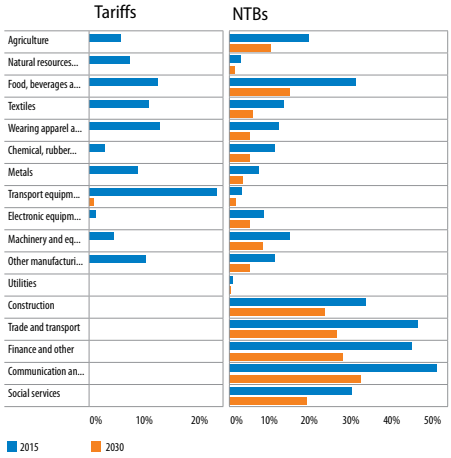
Source: World Bank staff estimates.

Figure 2.1. **Trade restrictions faced by Vietnam from EU partners, EVFTA scenario (%)**



Source: World Bank staff estimates.
Note: NTBs = non-tariff barriers.

Figure 2.2. **Trade restrictions imposed by Vietnam on EU partners, EVFTA scenario (%)**



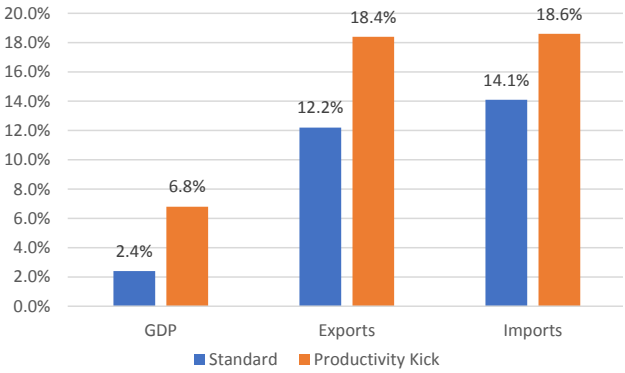
Source: World Bank staff estimates.
Note: NTBs = non-tariff barriers.

2.2. Results

2.2.1. Macroeconomic results

Under the EVFTA, Vietnam has the potential to grow faster, and to increase its GDP and trade flows. The estimated gains indicate a GDP increase of 2.4%, in standard productivity, by 2030, relative to the baseline scenario, increasing to 6.8% when the productivity kick is applied (figure 2.3). Exports and imports would increase by 12% and 14%, respectively, and get a higher boost

Figure 2.3. **Macroeconomic impact of the EVFTA on the Vietnamese economy by 2030 (% deviations with respect to baseline)**



Source: World Bank staff estimates.

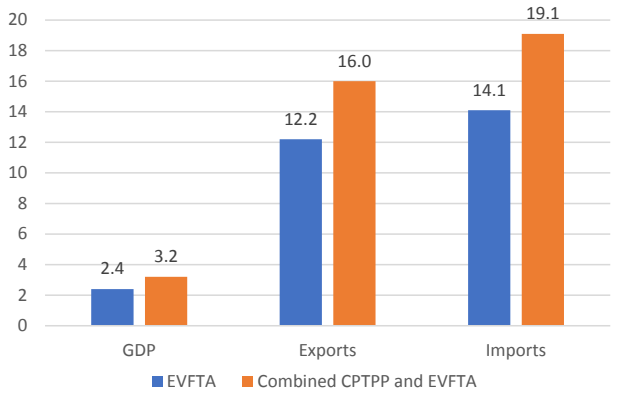
when the productivity kick assumption is applied, with an increase of 18% (figure 2.3). The high impact of the EVFTA in Vietnam is mainly driven by a high reduction of trade barriers between the two economic blocs.

The EVFTA entails substantial trade liberalization, and trade flows from and to the EU are likely to increase significantly. In 2018, one of the most dynamic export sectors for Vietnam[10] was apparel (around 22 percent of its trade), with the United States, the East Asia and Pacific region, and the EU[11] being the main export destinations. For the electronics and electrical equipment sector, the EU is one of the main partners together with China. However, high barriers between Vietnam and the EU are hampering Vietnam's efforts to take full advantage of the potential exports to the EU.

Selected manufacturing sectors such as textiles, food, and services would see their production expand faster under the EVFTA. Part of the increased output would be exported to the EU, including wearing apparel; textiles; and food, beverages, and tobacco. In terms of imports, we see an increase in most of the sectors, with sharp increases of imports from the EU. However, due to a redistribution of resources to more productive sectors and an increase of imports, some sectors, such as agriculture and manufacturing, will likely see their production and exports decline.

To maximize the benefits, Vietnam should proceed with implementation of the EVFTA and CPTPP. Due to deeper liberalization and a higher number of potential markets opening to Vietnam under the CPTPP, Vietnam will see the highest benefits while participating in both FTAs. Vietnam's GDP could increase by up to 3.2 percent compared to the EVFTA alone (figure 2.4). With both FTAs, North America (Canada and Mexico) and the EU

Figure 2.4. **Macroeconomic impact of the CPTPP and EVFTA on the Vietnamese economy by 2030, standard productivity (% deviations with respect to baseline)**



Source: World Bank staff estimates.

[10] Based on the Global Trade Analysis Project (GTAP) v.9 database and model simulations.

[11] Vietnam exports around 7.7 percent of its trade to the United States, 4.7 percent to East Asia and Pacific, and 4.2 percent to the EU.

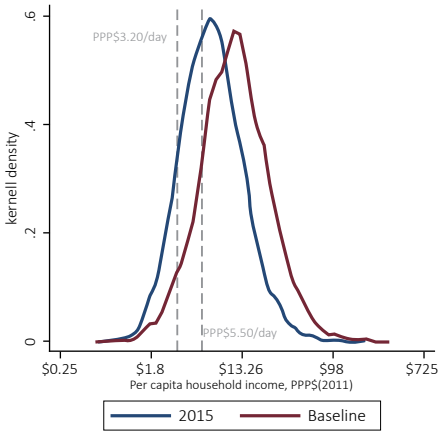
become important trading partners, and Vietnam sees an increase of trade flows with all the economies involved. Total exports could increase 16 percent relative to the baseline in the combined scenario compared with 12.2 percent under the EVFTA. Imports growth is also stronger in the combined scenario at 19.1 percent higher relative to the baseline compared to 14.1 percent under the EVFTA.

2.2.2. Poverty and distributional impacts

In the baseline scenario, Vietnam would see its poverty rate declining from 29% in 2016 to 12.6% by 2030 (at US$5.50 a day purchasing power parity [PPP]). Figure 2.5 shows the per capita income distribution in 2015 and 2030, for the baseline scenario. As income per capita grows, not only is there a shift of the income distribution to the right, but also a change in its shape resulting from modeling Vietnam's projected demographic and educational long-term outcomes. The proportion of population living in poverty, at each poverty line, can be calculated measuring the area below each distributional line and to the left of each poverty line. Under our baseline assumptions, Vietnam would achieve upper middle-income status by 2030. In this report, poverty lines of US$3.20 a day PPP and US$5.50 a day PPP are preferred, instead of the extreme poverty line of US$1.90 a day that is typically used for low-income countries. A decrease in poverty is thus projected for the next 14 years, with poverty at US$5.50 a day PPP having the sharpest decrease, declining from 29 percent in 2016 to 12.6 percent by 2030.[12] In the EVFTA scenario, poverty reduction would be more robust, further decreasing to 11.9 percent by 2030 (see figure 2.6). At US$3.20 a day PPP, poverty reduction is expected to decline from 8 percent to 3.6 percent under our baseline assumptions, and to 3.5 percent with implementation of the EVFTA.

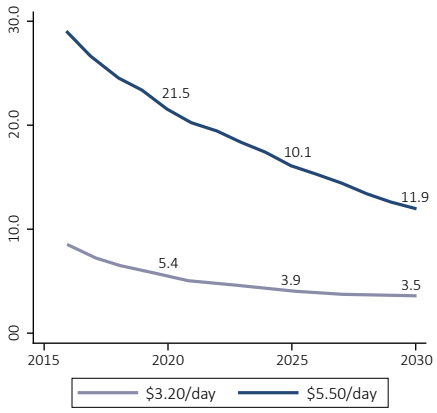
[12] Poverty rates were updated based on PovcalNet data as of February 2022 (http://iresearch.worldbank.org/PovcalNet/povOnDemand.aspx).

Figure 2.5. **Income distribution in Vietnam under baseline conditions, 2015 and 2030**



Source: World Bank staff calculations.

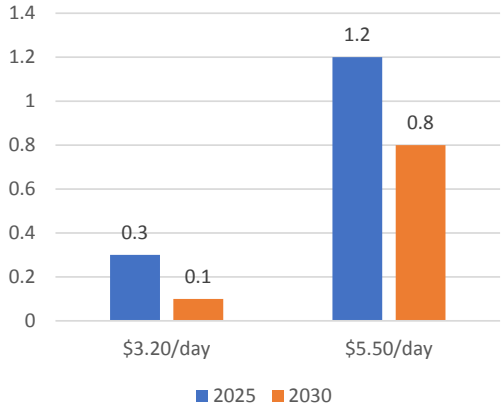
Figure 2.6. **Poverty headcount ratio (%) in Vietnam under the EVFTA**



Source: World Bank staff calculations.

The EVFTA could lift an additional 0.8 million people out of poverty by 2030 and contribute to closing the gender wage gap. With the assumption of standard productivity and with respect to the baseline, the EVFTA could lift an additional 0.1 million people out of poverty at US$3.20 a day PPP, while measured with the US$5.50 a day PPP poverty line, 0.8 million could be lifted out of poverty by 2030 (figure 2.7). Further, while the baseline scenario contemplates a moderate increase in the gender wage gap[13] (that results from an increasing demand for skilled labor in sectors that are dominated by men), with the implementation of the EVFTA, the gender wage gap would decrease particularly for households in the bottom 40 percent of the income distribution. By contrasting figure 2.8 and figure 2.9, it can be observed that the male-to-female earnings ratio for skilled workers

Figure 2.7. **People lifted from poverty due to the EVFTA, standard productivity**

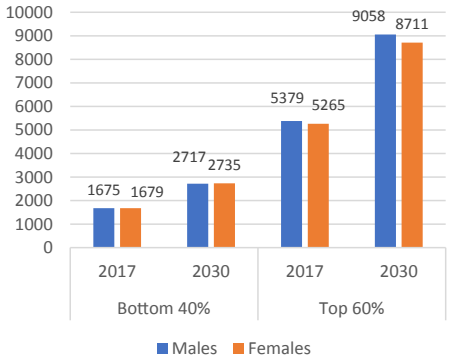


Source: World Bank staff estimates.

[13] Measured by relative per capita household consumption of males compared to females, aged 15 to 64.

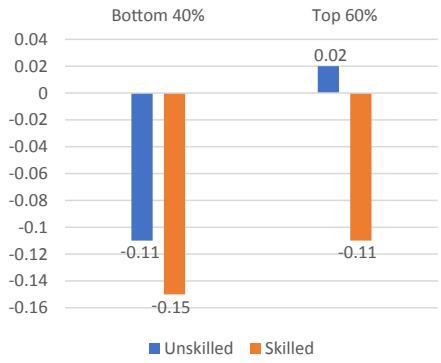
in the bottom 40 percent would decrease 0.15 percentage points with respect to the baseline. In comparison, the gender effects that the EVFTA would have on the top 60 percent of the income distribution are relatively smaller, with the male-to-female wage ratio decreasing 0.11 percentage points, while that of unskilled labor would have negligible results.

Figure 2.8. **Gender gap in 2017 and 2030, EVFTA scenario with standard productivity**



Source: World Bank staff estimates.

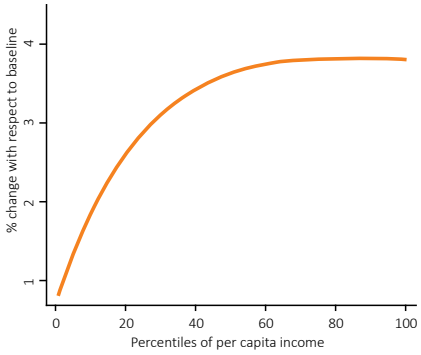
Figure 2.9. **Gender gap effects with respect to the baseline, EVFTA scenario with standard productivity**



Source: World Bank staff estimates.

The EVFTA would create more economic opportunities for skilled workers, bringing more benefits to households at the higher end of the income distribution. Figure 2.10 reflects, for each percentile of the income distribution, the absolute gains in income per capita relative to baseline conditions. Gains shown in the growth incidence curve result from applying the microsimulation based on the Vietnamese Household Living Standards Survey (2012). The microsimulation recovers macroeconomic shocks for the EVFTA, taking into consideration (a) sectoral reallocation of labor, (b) changes in relative wages, and (c) changes in real household consumption.[14]

Figure 2.10. **Growth incidence curves for the EVFTA, standard productivity assumptions**



Source: World Bank staff estimates.

[14] For details see Maliszewska, Olekseyuk, and Osorio-Rodarte (2018).

2.3. Conclusion

The EVFTA can bring significant benefits to the Vietnamese economy, not only on a macroeconomic level with increasing GDP and trade flows, but also in terms of poverty reduction. This assessment also suggests that implementation of the EVFTA and CPTPP together could result in higher gains compared to implementation of the EVFTA alone. However, the economic benefits from the FTA will not be equally distributed across the Vietnamese economy due to a reallocation of resources to more productive sectors, making it necessary to conduct a more comprehensive analysis to assess domestic policies to mitigate the potential negative effects on some sectors of the economy.

The impact on poverty by the EVFTA is also significant. An additional 0.8 million people could be lifted out of poverty at US$5.50 per day PPP by 2030, equivalent to a decline of 0.7 percent in the poverty headcount ratio. Since the EVFTA ambitious trade agenda would create faster growth and a quick expansion of the economy, it will also increase demand for skilled labor, which, other things being equal, will lead to higher income inequality. To take full advantage of the benefits of further trade integration, implementation of the EVFTA should be followed by strong efforts to enhance competitiveness and trade facilitation, while also creating domestic policies that safeguard negatively impacted households. Vietnam also faces additional challenges in its continual improvement in connectivity to enable deeper integration into global value chains. These simulations are sensitive to the key assumptions such as no further improvements in the Vietnamese education system beyond current demographic trends and perfect mobility of workers across sectors.

Chapter 3

LEGAL GAP ASSESSMENT FOR VIETNAM'S IMPLEMENTATION OF THE EVFTA[15]

[15] This chapter was prepared by Brian Mtonya, based on the report, "Legal Review and Gap Assessment for Vietnam's Implementation of the Free Trade Agreement between Vietnam and the EU," by Dr. Nguyen Ngoc Ha (World Bank Consultant) and Professor Jurgen Kurtz (World Bank Consultant), under a technical assistance funded by the Umbrella Trust Fund for Trade to the Ministry of Justice of Vietnam. A separate legal gap assessment in the report was also undertaken for the EVIPA, but this chapter only focuses on the EVFTA.

The legal gap assessment is expected to support the Vietnam National Assembly's ratification of the EVFTA in its upcoming session in May 2020, and government agencies' preparation of a clear roadmap for its implementation. The EVFTA legal gap assessment shows that Vietnam's domestic laws are mostly in compliance with its obligations under the EVFTA and that the country is ready to implement the agreement. There are a few laws and regulations that need to be addressed, and these have been clearly identified in the legal gap assessment for revision. Vietnam has benefited from the CPTPP ratification process and revision of domestic laws, as most of the provisions of the EVFTA are compatible with those of the CPTPP. However, there are some commitment levels that are wider and higher than any other FTAs that Vietnam has signed, including with the WTO and ASEAN.

3.1. Overview

The European Union (EU) and Vietnam, on June 30, 2019, signed the European Union-Vietnam Free Trade Agreement (EVFTA) and the Investment Protection Agreement (EVIPA). The European Parliament ratified both the EVFTA and EVIPA (which will replace 21 existing Bilateral Investment Treaties between EU member countries and Vietnam) on February 12, 2020. The EVFTA is expected to be ratified by the National Assembly of Vietnam in May 2020.

A legal gap analysis was undertaken in mid-2019 that focused on those areas of the EVFTA against which current Vietnamese laws contain some inconsistencies or gaps that will require attention to ensure consistency between the laws of Vietnam and the EVFTA. This chapter summarizes the outcome of that legal gap assessment.

The EVFTA contains 17 chapters, 18 annexes, four mutual declarations, two protocols, and two understandings covering several aspects found in typical FTAs. Several of these chapters and provisions require no amendment of domestic laws for implementation.

According to the legal gap assessment, some areas of Vietnamese laws that are significantly affected by the EVFTA are intellectual property, labor, environment, rules of origin, pharmaceuticals, cars, trade in goods, some services, and government procurement. As part of the process of ratifying the CPTPP, Vietnam conducted several legal reviews of its legal system. This process has contributed to lessening the areas in the legal system that are affected by EVFTA commitments, because commitments under the CPTPP in certain areas are similar to those of the EVFTA. Therefore, a significant number of laws and regulations that were already amended (or proposed to be amended) to be consistent with CPTPP, will be, at the same level, consistent with the EVFTA.

While in principle the amended domestic rules only apply to the EU and its member states, in certain areas, such as labor and the environment, once the laws of Vietnam change, this will affect all trading partners. In addition, some FTAs to which Vietnam is party have an automatic Most Favored Nation (MFN) clause for trade in goods, services, and investment. Therefore, in those areas, the modification of domestic laws to give preferential access to the EU will automatically open these areas to other FTA parties, such as members of the CPTPP and the Free Trade Agreement between Vietnam and the Eurasian Economic Union (VN-EAEU FTA). With these provisions, the implementation of commitments on investment and services of Vietnam under the EVFTA will have an effect not only on EU members, but on some other countries, as well.

3.2. Outcome of the legal gap analysis between the EVFTA and Vietnamese domestic laws

The following legal gap analysis is a chapter-by-chapter summary of the 17 chapters of the EVFTA.

Chapter 1. Objectives and general definitions

Chapter 1 introduces the objectives and general definitions used in the subsequent chapters of the EVFTA. The objective of the EVFTA is to liberalize and facilitate trade and investment between the Parties in accordance with the provisions of this Agreement. Although some of the definitions may not be found in domestic laws, the definitions mainly restate those of the WTO agreement. Therefore, these definitions can be applied directly without amending domestic laws.

Chapter 2. National treatment and market access for goods

Chapter 2 of the EVFTA provides market access commitments of Vietnam to the EU's goods and vice versa. The chapter contains specific commitments on the elimination of tariffs (on tariff lines, schedule of elimination and reduction from the date of entry into force of the agreement) and issues relating to the import and export of goods between Vietnam and the EU (customs, export duties, import duties, certificates of export, fees related to exportation).

Import and export duties

The Tariff Schedule of Vietnam in the EVFTA has not been regulated in Vietnamese law. Article 11 of the Law on import and export duties of 2016, which provides for

duty tariffs and duty rates, and as a common approach, is already being used to implement the CPTPP. It is suggested that the Government of Vietnam issue a Decree on Schedule of preferential export and import duties.

Provisions on special goods

(a) Remanufactured goods

Neither the Law on Foreign Trade Management of 2017 nor the Commercial Law of 2005 contains provisions on remanufactured goods. In the case of the CPTPP, after the agreement came into effect, the Government of Vietnam issued Circular 03/2019/TT-BCT dated January 1, 2019 on rules of origin for goods imported from CPTPP members, Article 7 of which regulates remanufactured goods. However, to date, the relevant laws of Vietnam have not regulated the issue of remanufactured goods as provided for in the EVFTA. Therefore, Vietnam could consider issuing another circular on origin of goods imported from the EU, to implement Article 2.6 and Annex 2A5 of the EVFTA.

With respect to the deadline for issuance of such a legal document, Vietnam and the EU shall have a transitional period of no longer than three years from the date of entry into force of the EVFTA to implement these provisions.

(b) Motor Vehicles and Motor Vehicle Parts and Equipment

Point 3 Article 6.2.a of Decree No. 116/2017/ND-CP dated 17/10/2017 of the Government on detailing conditions to produce, import, assemble, guarantee and repair services of a motor vehicle provides that "in cases of imported cars that have a conformity assessment certificate issued by countries or territories which signed a mutual recognition agreement with Vietnam, the requirements for such motor vehicles to ensure quality, safety and environmental protection standards shall be in accordance with that mutual recognition agreements." However, Article 6.2.a has been recently amended by Decree No. 17/2020/ND-CP dated 05/02/2020, so that, Vietnamese law is now compatible with Article 4 Annex 2 B of EVFTA.

To facilitate businesses relating to motor vehicles and motor vehicle parts and equipment and mutual recognition of United Nations Economic Commission for Europe (UNECE) certificates on cars and car parts, and equipment originating from UNECE members, Vietnam should consider joining the UNECE 1958 Agreement. Since the country only has a three-year transition period after the date of entry into force of the EVFTA to fully comply with Annex 2B, Vietnam should consider accession to this Agreement.

Chapter 3. Trade remedies

Trade remedies are provided in Chapter 3 of the EVFTA, which include detailed provisions on antidumping safeguards and subsidies measures. The chapter ultimately reflects WTO agreements on trade remedies, with some technical changes to suit bilateral trade relations between Vietnam and the EU. In the case of Vietnam, the Law on foreign trade management of 2017 and Decree No. 10/2018/ND-CP dated January 15, 2018 of the Government on detailing some provisions of the Law on foreign trade management of 2017 are consistent with Chapter 3 of the EVFTA. Therefore, there is no need to amend domestic laws to implement trade remedy provisions in the EVFTA.

Chapter 4. Customs and Trade Facilitation

Chapter 4 provides measures for the management of import, export, and transit of goods between Vietnam and the EU. Apart from this chapter, commitments on customs and trade facilitation are regulated in Protocol 2 on Mutual Administrative Assistance in Customs Matters. Protocol 2 does not, however, deal with substantive rights and obligations of the Party concerning customs and trade facilitation subjects, but with assistance in customs matters.

In general, the Law on customs of 2014 is compatible with Chapter 4 of the EVFTA. In the future, when issuing new regulations in specific areas, attention should still be paid to ensure this compatibility.

The EVFTA also requires establishment of a Specialized Committee on Customs. It is proposed that the Government of Vietnam assign a lead agency to be in charge of the work in the Specialized Committee on Customs.

Chapter 5. Technical Barrier to Trade

Chapter 5 covers mandatory technical regulations and voluntary standards that define specific characteristics that a product should have, such as its size, shape, design, labeling, marking, packaging, functionality, and performance. The chapter also covers specific procedures used to check and demonstrate whether a product is in compliance with these requirements. These so-called “conformity assessment procedures” can include, for example, product testing, inspection, and certification activities. Chapter 5 goes beyond the obligations of the WTO Technical Barriers to Trade (TBT) Agreement to which both the EU and Vietnam are signatories. The gap analysis found that there is no gap between Chapter 5 and domestic laws, so no amendments to Vietnamese law are required. However, issuing a Decision of the

Prime Minister on the appointment of contact points, addressed together with other required institutional issues, is necessary to comply with this chapter.

Chapter 6. Sanitary and Phytosanitary

Chapter 6 reaffirms all principles of the WTO Sanitary and Phytosanitary (SPS) Agreement and makes references to a number of standards developed by international bodies, which include the Codex Alimentarius (Codex) in food safety, the World Organization for Animal Health (OIE) in animal health, and the International Plant Protection Convention (IPPC) in plant health. It has gone beyond WTO rules and is not a direct replication of the WTO SPS agreement.

There are certain divergences from the WTO SPS Agreement, but they do not significantly modify the level of commitments of the EU and Vietnam under the SPS agreement. They do, however, provide more guidance or technical requirements that facilitate implementation of existing WTO obligations, such as requirements on transparency and technical assistance.

With regard to emergency measures, relevant domestic laws do not specify commitment in Article 6.14 of the EVFTA. In particular, Article 102 of the Law on foreign trade management of 2017 provides for consultation in case of application of emergency control measures.

Article 6.14 of the EVFTA requires consultation and, similarly, Article 102 requires consultation with trading partners directly affected by the measure in conformity with the relevant treaty to which the Socialist Republic of Vietnam is a contracting party. However, this Article does not deal with how to conduct the consultation. Therefore, to implement Article 6.14 effectively, Vietnam should assign a lead agency or ministry to be in charge of emergency SPS measures, and that assigned agency should issue circular(s) on guiding consultation procedures in case of the enforcement of an SPS emergency measure.

Chapter 7. Non-Tariff Barriers to Trade and Investment in Renewable Energy Generation

Chapter 7 covers the issue of non-tariff barriers to trade and investment in renewable energy generation. The chapter does not apply to either research and development projects, demonstration projects carried out on a non-commercial scale, or projects funded and governed by agreements with international organizations or foreign governments to which the procedures or conditions of those donors apply.

In the case of Vietnam, there are about 15 laws regulating the issue of non-tariff barriers to trade and investment in renewable energy generation. In general, the domestic laws of Vietnam are compatible with Chapter 7, except for the minor issues relating to some definitions provided in Article 7.2 of the EVFTA, such as "renewable and sustainable sources" and "environmental service", that are not sufficiently clarified in domestic laws. Second, the Government of Vietnam should appoint a lead agency and members of relevant committees, who shall be responsible for matters covered under this chapter.

Chapter 8. Liberalization of investment, trade in services, and electronic commerce

The gap analysis of Chapter 8 reveals that there are certain areas (such as distribution services, financial services, insurance and insured-related services, reinsurance and retrocession, maritime transport services, air transport services, telecommunications, value-added services) in which domestic laws are inconsistent with provisions of the chapter and its annexes. It is recommended that Vietnamese commitments in these areas apply directly to service suppliers from the EU, or the Government of Vietnam can consider issuing a legal normative document detailing the list of services that can be applied directly.

The commitments on the movement of natural persons are compatible with domestic law, except for relevant provisions in the Law on entry, exit, transit, and residence of foreigners in Vietnam of 2014, which are inconsistent with Article 8.14 and 8.15 of the EVFTA with regard to the time period for entry and temporary stay of managers or executives and for specialists. In particular, the Law of Vietnam provides a shorter time period.

The other gap is found in Article 17.3 of the Law, which allows sellers to stay for up to 30 days (instead of 90 days, as provided in the EVFTA). In addition, the gap analysis shows that Article 8 of Decree No. 11/2016/NĐ-CP of the Government dated February 16, 2016 on detailing some provisions of the Labor Code with regard to the length of time to certify foreign workers who do not need a labor permit certificate in Vietnam is not consistent with Article 8.14 and 8.15. It is recommended that these commitments can be applied directly.

Chapter 9. Government procurement

Chapter 9 applies to any measure regarding covered procurement, whether or not it is conducted exclusively or partially by electronic means. It contains two sets of provisions, the main text of Chapter 9 and two Annexes, Annex 9-A on Coverage of

Government Procurement for the EU, and Annex 9-B on Coverage of Government Procurement for Vietnam.

In general, Vietnam and the EU have agreed on disciplines in line with the WTO Government Procurement Agreement rules of the World Trade Organization. In fact, the basic principles and procedures provided in Chapter 9 are similar to those in the Agreement on Government Procurement. Vietnam's commitments on government procurement only apply to tenders from the EU. Some provisions of Chapter 9 are already provided in domestic laws, but many are not yet provided, especially regarding provisions on the use of electronic means, rules of origin, offsets, the "multi-use list," and services procurement.

The EVFTA is one of two new FTAs through which Vietnam has committed to open its market on government procurement to foreign tenders (the other being the CPTPP). With respect to government procurement that Vietnam commits to tenders from the EU, according to Vietnamese laws, Vietnam has not allowed foreign tenders to participate in government procurement projects using government budget that fall outside the scope of application of the Law on Bidding. This provision does not apply to bidding packages that use foreign debt or official development assistance for which the donor or lender has special requirements on the nationality of tenders.

Ultimately, the scope of application of the Law on Bidding of 2013 already covers the main issues regulated by Chapter 9 of the EVFTA. However, there may be certain differences between the Law of Vietnam and the EVFTA. Given the nature of bilateral trade relations regulated by Chapter 9, Vietnam only opens its market to tenders from the EU. As with the CPTPP, it is suggested that Vietnam consider issuing a legal normative document guiding all differences between the Law of Vietnam and the EVFTA in this regard. This legal normative document shall apply exclusively to government procurement measures that fall into the scope of application of the EVFTA.

Chapter 10. Competition policy

Chapter 10 has two sections that cover the issues of competition policy: (a) anticompetitive conduct, and (b) subsidies. The gap analysis reveals that no amendments or revisions of domestic laws are required.

Chapter 11. State-owned enterprises, enterprises granted special rights or privileges, and designated monopolies

Chapter 11 contains rules regarding state-owned enterprises (SOEs), designated monopolies (public and private), and enterprises granted special rights or privileges

in order to ensure that trade liberalization achieved by the agreement is not undermined by the unfair behavior of such companies. An ambitious, high-level agreement on SOEs has been reached. This is a significant achievement given that SOEs, which create around 40% of GDP, have traditionally been the backbone of the Vietnamese economy. The laws of Vietnam on SOEs grant special rights or privileges, and designated monopolies are consistent with provisions of Chapter 11. The gap analysis does not suggest amendment or revision of domestic law to implement Chapter 11.

Chapter 12. Intellectual property

Chapter 12 covers intellectual property and consists of two Sections: Section A on general provisions and principles, and Section B on standards concerning intellectual property rights.

The gap analysis points out the following inconsistencies between Chapter 12 and Vietnamese laws:

(i) Vietnamese law meets the requirements on the revocation of a registered trademark of the EVFTA, except for these elements: the term "genuine use" and the exemption of three months of use before the request to terminate protection. Therefore, to implement Article 12.22 on revocation of a registered trademark, it is suggested that the term "genuine use" be incorporated in domestic law as its intended use in the EVFTA.

(ii) Article 12.22.3 could be interpreted as the use of a registered trademark by the proprietor of the trademark, which could mislead the consumer, is an act that infringes on the rights and interests of another person according to Article 7.2 of the Law on intellectual property of 2009. Although Vietnam's law is compatible with the EVFTA's commitments in this area, it is recommended that the need to provide additional provisions on the termination of a trademark's protection will be examined in the case when its use could mislead the consumer, to determine whether the current legal framework on this matter is adequate to protect the interest of the consumer in accordance with the Law on intellectual property or the Law on preventing anticompetitive behaviors.

(iii) Vietnam's law does not put a limit on the type of goods eligible for geographical indications to be protected (larger in scope than the EVFTA); however, to fully comply with Article 12.23 on the scope of application, the need for a high level of protection for all geographical indications should be examined.

(iv) To implement Article 12.27 on protection of geographical indications, it is recommended that the validity of these two options be examined:

(a) Maintaining two levels of protection: (i) a high level of protection for geographical indications under the EVFTA agreement, and (ii) a normal level of protection for geographical indications protected under the channel of domestic law; or

(b) Unify one high level of protection. When unifying less than one level of protection, it is necessary to determine whether it would be applied to all goods or only groups as specified in the EVFTA.

(v) To implement Article 12.27.3 on protection of geographical indications, it is recommended that provisions be added for the protection of homonymous geographical indications, including the obligation to notify on the process of negotiation; and to examine the validity of adding provisions to the intellectual property law when the geographical indication is no longer protected in its country of origin.

(vi) Article 12.28 provides for exceptions specifying the special exemption for the geographical indications of "Asiago," "Fontina," "Gorgonzola," "Feta," and "Champagne." It is recommended that these designations be applied directly and specifically in instructing legal documents.

(vii) To implement Article 12.29 on Right of Use of Geographical Indications, it is recommended that amendments be drafted allowing administrative agencies to issue user licenses, thereby minimizing the obligations to only publish licensed entities. It is also recommended that a method be created to gather and publish information on the licensed entities.

(viii) To implement Article 12.35 on protection of registered industrial designs, it is recommended that the novelty aspect be further examined and defined. For example, does "novelty" include "creativity"? "Novelty" and "creativity" as both could be regarded similar in description. Therefore, the Law on Intellectual Property needs to be restructured accordingly.

(ix) To implement Article 12.39 on patents and public health, it is recommended that the experience of developing countries such as India, Thailand, the Philippines, Brazil, and Argentina be considered in implementing provisions on the guarantee of access to medicine for the population in the intellectual property sector.

Chapter 13. Trade and sustainable development

The chapter enumerates specific provisions in the area of trade and sustainable development, with the twofold aim of (1) promoting mutual supportiveness among trade and investment, labor, and environmental policies; and (2) ensuring that increased trade and investment do not come at the expense of workers and environmental protection. The chapter includes obligations on the part of both the EU and Vietnam regarding a core set of labor and environmental issues.

First, with respect to the Labor Code, similar to the CPTPP, Chapter 13 of the EVFTA requires amendment of the Labor Code and its guiding documents to be consistent with obligations under the International Labor Organization (ILO) and the ILO Declaration on Fundamental Principles and Rights at Work and its Follow-up, adopted by the International Labor Conference at its 86th Session in 1998, to respect, promote, and effectively implement the principles concerning fundamental rights at work. The National Assembly adopted the amendment to the existing Labor Code, taking into account the CPTPP's commitments in that respect. Therefore, there is no need to revise the Labor Code to implement the EVFTA because the two Agreements have the same level of commitment.

Second, with respect to Biological Diversity, under Article 13.7, the gap analysis shows that the Law on Environment Protection does not have compatible provisions. Therefore, it is recommended that the following definitions be added to relevant laws and regulations:

(i) Encourage trade in products that contribute to the sustainable use and conservation of biological diversity, in accordance with Vietnam's domestic laws and regulations.

(ii) Promote and encourage the conservation and sustainable use of biological diversity, including access to genetic resources and the fair and equitable sharing of benefits arising from their use.

(iii) Promote and encourage trade-related aspects of the current and future international climate change regime, including means to promote low-carbon technologies and energy efficiency.

(iv) With respect to establishment of the Committee on Trade and Sustainable Development, the Government of Vietnam should appoint a lead agency and official responsible for implementing and supervising this chapter.

(v) Establish a panel of experts to mediate conflicts between Parties with regard to implementation of Chapter 13.

Chapter 14. Transparency

Both Parties recognize the impact that the regulatory environment and procedures might have on trade and investment, and each Party shall promote a predictable regulatory environment and efficient procedures for economic operators, especially small and medium-sized enterprises. Chapter 14 addresses the issue of drafting and implementing laws and measures concerning subjects under the scope of the EVFTA. The Law on legal normative documents of 2015 is fully compatible with the provisions of Chapter 14. Therefore, the legal gap analysis does not suggest amendment of domestic law in this regard.

Chapter 15. Dispute settlement

The EVFTA improves on the existing WTO dispute settlement in the following respects:

(i) There is a faster system and stricter deadlines. The EVFTA dispute settlement proceedings are much faster than in the WTO. While a case in the WTO dispute settlement system can take up to 860 days, under the EU's FTA with Vietnam it can take 425 days.

(ii) There is a more efficient system of panel composition. The EVFTA will establish a mandatory use of roster lists of arbitrators, which is designed to enhance the mutual trust in arbitrators and the efficiency and automaticity of the panel selection process. The advantage of this system is that it is less exposed to litigation tactics, and arbitrators enjoy the general support of both Parties.

(iii) The EVFTA also enhances the transparency of dispute settlement proceedings compared to the WTO by providing that, subject to certain confidentiality rules, panel hearings are generally open to the public. In addition, the EVFTA establishes the right of private parties in either Party to submit amicus curiae briefs (information relevant to the case) to the panel.

(iv) An elaborated and innovative mediation mechanism is established. The EVFTA clarifies the scope, procedural rules, and effect of the mediation. The mediation mechanism is a voluntary system to which the Parties subscribe on an ad-hoc basis.

To implement Chapter 15 of the EVFTA, it is recommended that the Government of Vietnam assign a lead agency to be in charge of this chapter, and that the rules and procedures under Chapter 15 be applied directly, taking into account past experience dealing with WTO disputes.

Chapter 16. Cooperation and capacity building

According to Article 16.1 on objectives and scope of this chapter, the Parties affirm the importance of cooperation and capacity building for the efficient implementation of this Agreement, which supports the continued expansion of, and creates new opportunities for, trade and investment between them. The gap analysis shows that Chapter 16 does not create direct obligations. It is compatible with the fundamental principles of the Constitution of 2013, and with the Law on treaties of 2016. Chapter 16 requires no amendment of domestic law in this respect.

Chapter 17. Institutional, general, and final provisions

Provisions of Chapter 17 are consistent with the fundamental principles of the Constitution of 2013, and with the Law on treaties of 2016 with regard to implementation of treaties to which Vietnam is a party. The gap analysis concludes that this chapter requires no amendment of domestic law.

Chapter 4

THE EVFTA – KEY IMPLEMENTATION ISSUES[16]

[16] This chapter was prepared by Duc Minh Pham, Brian Mtonya, and Dongwook Chun.

Complying with rules of origin and sanitary and phytosanitary (SPS) requirements is among the most challenging implementation issues in maximizing EVFTA benefits. The current status of Vietnam's shallow engagement in global value chains and the high dependence of its key exports on imported materials, especially from non-EU members, is the main barrier preventing Vietnamese firms from taking full advantage of tariff reductions, and this situation will need to improve. Regulations on non-tariff measures (NTMs) in general and SPS measures, in particular, remain complicated, which makes NTM cost incidence in Vietnam higher than in most other ASEAN countries—a factor limiting Vietnam trade capacity in general, and potential gains from the EVFTA, in particular. Efforts should also be made to cope with increased flows of foreign direct investment (FDI) as a result of EVFTA implementation. Among the key recommendations discussed in this chapter are an integrated approach to developing efficient transport corridors based on value chain spatial structure, applying more transparent and predictable border procedures and non-tariff measures, an improved logistics regulatory environment to facilitate a general reduction in trade costs, and introducing both a more liberal stance on FDI and a systemic investment response mechanism.

Given the limited length of this report, four key challenges are chosen for discussion in this chapter. First, the challenge dealing with *rules of origin*[17] is reflected in the strict thresholds in terms of both minimum domestic origin and maximum non-EU originating materials (among other things) that Vietnam's exports will need to meet in order to enjoy the EU preferential tariff schedule. Recommendations include, among others, enhancing the sophistication of domestic production and increasing export value addition. Second, Vietnam's exports, especially agricultural products, will be required to meet high quality and rigorous *sanitary and phytosanitary standards* (SPS),[18] and transparent labeling in terms of environmental and food safety information. This is critical for an economy like Vietnam, where agriculture plays a significant role. The key recommendation is to simplify and modernize the SPS management system to ensure its effectiveness while minimizing compliance costs for businesses. Third, the EVFTA will boost increased FDI flows, and a key challenge facing Vietnam is to manage the increasing number of commercial grievances caused by *disputes between investors and the state*, and complying with investment protection articles regulated under the EVIPA. This chapter recommends implementing an early warning and report system for FDI disputes. Finally, the pandemic could have strong implications for policy response if Vietnam wants to *take advantage of the EVFTA in the post-COVID-19 era.*

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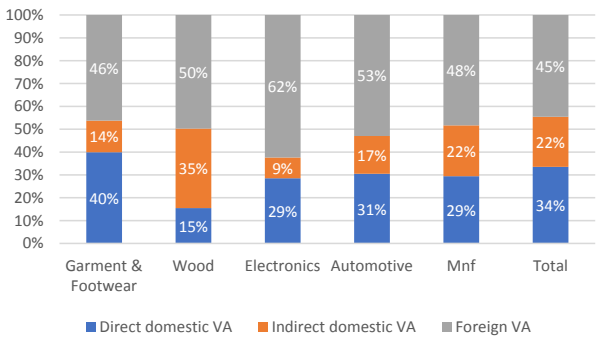
[17] Rules of origin regulated in detail under Protocol 1, and Paragraph 2 of Article 2 of Chapter 2 on national treatment and market access for goods of the EVFTA.

[18] Agreement on SPS measures is presented in Chapter 6 of the EVFTA.

4.1. Maximizing benefits from preferred tariff reduction by complying with rules of origin

Vietnam's shallow engagement in global value chains (GVCs) and the high dependence of its exports on imported materials, coupled with the EVFTA's strict rules of origin, could prevent Vietnam from maximizing EVFTA benefits from tariff reduction. Using data from TiVA, the WTO's Trade in Value-Added database, figure 4.1 graphically shows that Vietnam's manufacturing sector uses higher foreign value added than domestic value added (62 percent of inputs from foreign countries in the electronics sector and 53 percent in the automotive sector).

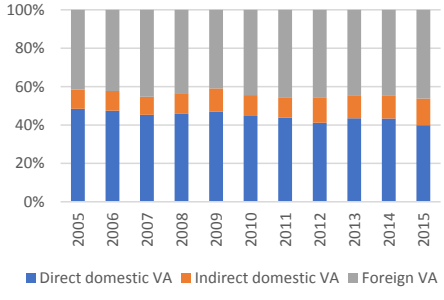
Figure 4.1. **Foreign value added compared to domestic value added**



Source: TiVA, OECD.

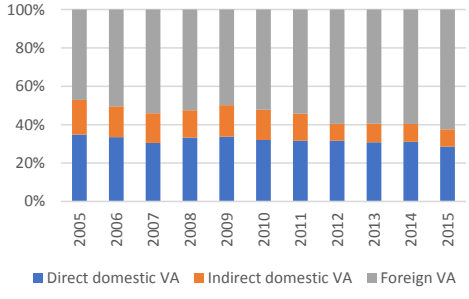
The increase in foreign value added over time and the dependency on sector inputs from non-EU members in key export manufacturing industries such as textiles and garments, footwear, and electronics, reflect risks Vietnam faces in maximizing tariff reduction benefits from the EVFTA. Figures 4.2 and 4.3 show that foreign value added in garments and footwear increased from 41.5 percent

Figure 4.2. **Value added in garments and footwear**



Source: TiVA; OECD.

Figure 4.3. **Value added in electronics**



Source: TiVA; OECD.

in 2005 to 46.2 percent in 2015. During the same period, foreign value added in the electronics sector increased even faster, from 12.1 percent in 2005 to 30.9 percent in 2015. Domestic value added should increase over time if Vietnam is to take advantage of the EVFTA and have more sophisticated productive capacity and deepened integration into GVCs.

Mitigating the risks of the lack of capacity to comply with rules of origin, however, creates a great window of opportunity for restructuring domestic supply chains toward closer links of domestic suppliers with foreign invested enterprises, which are lead firms in major GVCs. Facilitating GVC integration requires a comprehensive set of policy measures[19] including an integrated approach to developing efficient transport corridors based on value chain spatial structure and trade-related connective tendency[20]; a general reduction in trade costs, more transparent and predictable border procedures and non-tariff measures, and an improved logistics regulatory environment[21]; a more liberal stance on FDI; and better connectedness with external sources of demand and technology-related investment.

Efforts should be made to revamp existing regulations guiding compliance with rules of origin under the new generation FTAs. The process of certification and inspection of goods originating in Vietnam complies with Decree No. 31/2018/ND-CP of March 8, 2018, which provides details on the management of the origin of foreign trade in goods. Circular No. 03/2019/TT-BCT regulating the rules of origin of goods under the CPTPP issued by the Ministry of Industry and Trade (effective March 8, 2019) guides enterprises to ensure the rules of origin in order to enjoy tariff preferences under the CPTPP instead of the MFN tariff. These regulations should be reviewed and updated, or separate regulatory guidance should be newly issued to include the practices under the EVFTA, and to facilitate enterprises maximizing FTA benefits.

Vietnam should apply a regime of self-certification of origin to facilitate enterprises enjoying preferred tariffs applied under the EVFTA, while reducing documentary procedure costs. Under current EU regulations, any EU exporter can use either self-certification in cases of consignments not exceeding €6,000 in value, or the certificates issued by EU customs. In the future, the EU may move to a system of registered exporters (REX). Vietnamese exporters currently follow existing regulations to obtain certificates of origin from the Ministry of Industry and Trade (MOIT) or bodies authorized by the MOIT. The MOIT is currently drafting a

[19] See Hollweg, Smith, and Taglioni 2017.
[20] See World Bank 2019; Pham et al. 2019.
[21] See Pham and Oh 2018; and Pham, Artuso, and Mtonya 2018.

new Circular on rules of origin, by which Vietnamese enterprises exporting goods to the EU with the ex-factory price of no more than €6,000, or eligible exporters (as prescribed by Vietnamese laws), will be allowed to self-certify.

Vietnamese enterprises should be fully aware of the regulated flexibilities under the EVFTA in order to take full advantage of them. For example, in accordance with Protocol 1 of the EVFTA, Vietnamese traders should apply *cumulation*, if an EU textile producer may supply Vietnamese garment producers with fabrics originating in the EU, or a producer in the Republic of Korea provides fabrics used for producing garments after complying with certain administrative requirements. Vietnam will also benefit from cumulation with ASEAN countries with which the EU has an FTA in force for two fishery products: squid and octopus. Another example is the case of *duty drawback*, allowing exporters using inward processing schemes for subsequent export to Vietnam or to the EU in order to enjoy a suspension or reimbursement of duties applied to non-originating inputs used in the manufacture, if they have complied with *product-specific rules*. Another flexibility is the so called de *minimis*, that is, a case where the proportion of raw materials do not meet the criteria for conversion of commodity codes under the CPTPP. The "flexible" ratio allows 10 percent of raw materials that do not meet the rules of origin, but the finished product is still considered to be in compliance. One efficient way to raise the interest and awareness of the private sector in FTAs in general and the EVFTA in particular is to develop and launch a Free Trade Agreement Portal, as described in box 4.1.

Equally important is that related government agencies should also ensure sufficient awareness-raising activities so Vietnamese enterprises fully understand the seriousness of violating rules of origin. The violation of rules of origin, once recognized, will not only be a removal of tariff preferences under the EVFTA, but will also be seriously penalized, especially where it is considered a fraudulent transshipment subject to inspections for trade retaliation measures by trading partners within or outside the CPTPP and EVFTA blocks. A lesson learned was the case on July 2, 2019, when the U.S. Department of Commerce investigated whether to impose a tariff of up to 456 percent on some steel products produced in Korea or Taiwan, China, transshipped to Vietnam for further processing, and ultimately exported to the United States. From a state management perspective, the principle of non-alteration should be secured. This means that the products can transit through third countries, as long as they have not been altered, transformed, or subject to operations other than preserving them in good condition or adding or affixing marks, labels, seals, or any other documentation to ensure compliance with specific domestic requirements of the importing country.

Box 4.1. Free Trade Agreement Portal

Vietnam is party to a number of FTAs or other bilateral or multilateral trade agreements that allow exporters to take advantage of preferential tariff rates or treatment when exporting to countries that are parties to the same agreement. Typically, in order to take advantage of these preferential rates, an importer must provide proof of the origin of the goods according to a set of rules known as rules of origin and meet other mandatory obligations relevant to the goods or business sector.

The obligations and the rules of origin concerning FTAs can be complex, and in many cases even where information is available on the FTAs, they can be difficult to interpret and apply. To address this challenge, the World Bank Group, in collaboration with the Ministry of Industry and Trade, with support from Australia's Department of Foreign Affairs and Trade, has been developing and implementing a Free Trade Agreement Portal (FTAP) for Vietnam.

The FTAP will be a website that will allow Vietnamese importers and exporters, together with international investors, to quickly and easily discover the tariff rates applicable to goods and provide information about rules of origin and any non-tariff measures applicable to specific commodities. The FTAP will further extend to information on services and investments that are incorporated within the terms of certain FTAs to which Vietnam is a party.

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The FTAP will cover the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), the European Union-Vietnam Free Trade Agreement (EVFTA), and all active FTAs to which Vietnam is a party.

Once developed and launched, the FTAP will be operated by the Ministry of Industry and Trade (MOIT) of Vietnam, and therefore the project will provide training and support to enable MOIT designated staff to undertake everyday management of the portal.

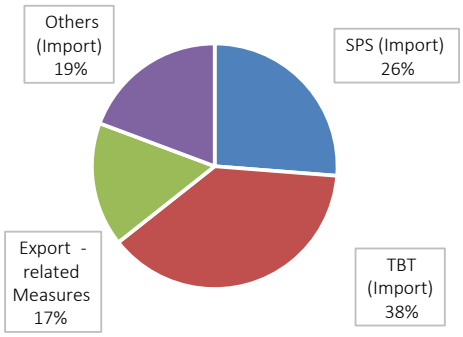
4.2. Non-tariff measures: SPS and food safety

As Vietnam signs and ratifies a number of new bilateral and multilateral free trade agreements (including the CPTPP and EVFTA), sanitary and phytosanitary (SPS) and food safety requirements are becoming more significant technical barriers that Vietnam must address and overcome if it is to increase its higher-value exports. Many Vietnamese exporters fail to meet the requisite SPS requirements or the traceability, quality, and food safety requirements. High levels of chemical residue in many fruit export shipments in recent years have also diminished Vietnam's reputation in the international market.

SPS measures in Vietnam are coordinated by the Vietnam Sanitary and Phytosanitary Notification Authority and Enquiry Point (Vietnam SPS, for short), which was established under Decision No. 99/2005/QD-TTg on May 9, 2005, and which acts as the main body that monitors and administers the country's obligations required under the World Trade Organization's Agreement on Application of Sanitary and Phytosanitary Measures.

The number of SPS measures are second only to the number of measures on technical barriers to trade. According to Vietnam Trade Information Portal data, of 402 non-tariff measures (NTMs), Vietnam has 263 technical measures and 73 nontechnical measures. Among technical measures for imports, SPS measures account for 26 percent of NTMs (figure 4.4).

Figure 4.4. **Structure of NTMs in Vietnam**

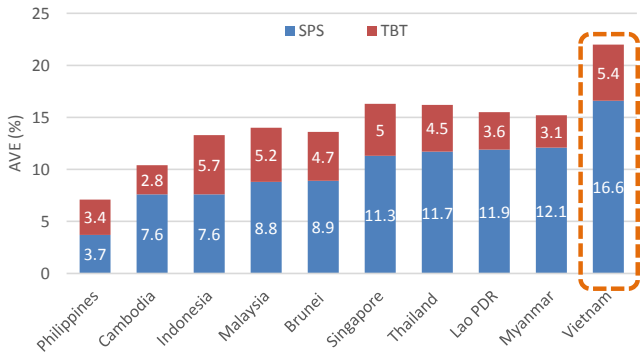


Source: Pham, Artuso, and Mtonya 2018.

As was noted in the December 2018 World Bank report, "Taking Stock: An update on Vietnam's recent economic developments…," trade costs in general and the cost incidence of NTMs in Vietnam are higher than that of most other ASEAN countries. Using data from trade information portals established with World Bank support in other countries, this report shows that Vietnam has a much higher number of legal documents, procedures, and forms related to NTMs than comparator countries. This results in higher trade costs on business. Using ad valorem equivalents, which quantify the effect of NTMs in much the same way as the effect of a tariff measure,

it has been calculated that while the ASEAN average ad valorem equivalent of SPS measures is 8.34 percent, in Vietnam it is 16.6 percent (figure 4.5). This implies that there is room for policy maneuver for Vietnam to reduce the ad valorem equivalent of NTMs.

Figure 4.5. **AVE for SPS: Vietnam compared to ASEAN countries**



Sources: World Bank staff calculations based on Ing and Cadot (2018) data.
Note: AVE = ad valorem equivalent.

The December 2018 "Taking Stock…" Report recommended a set of reforms for simplifying NTMs (including SPS) and improving transparency. They include:

(i) Vietnam should establish a least-cost, transparent system of NTMs with uniform and consistent definition and classification in accordance with international standards and clear policy objectives (see box 4.2).

(ii) Specialized control regulatory requirements need to be simplified. Vietnam should embark on a deeper reform program by learning from international experience and best practice to establish a standard procedure for reviewing and applying cost-benefit analysis to be conducted by objective and capable bodies to eliminate deficiencies due to the lack of capacity and vested interests of direct NTM management units.

(iii) International experience shows that a prerequisite for effective automation of business processes through a national single window is to re-engineer complicated procedures enforcing the compliance process toward, and simplification and synchronization between, customs and other bodies designing and implementing NTMs.

(iv) NTM agencies in Vietnam should apply risk management and post-clearance inspection to achieve a balance between reducing risks that Vietnam could be exposed to by international trade and facilitating trade and competitiveness.

(v) A conducive interagency coordination mechanism is vital for this multidisciplinary reform program to be successful. The establishment of the National Committee on Trade Facilitation and National Single Window was a step in the right direction, but the next step should be to ensure that a well-functioning secretariat with specialized technical knowledge is in place to support the committee in carrying out its directions for, and overseeing implementation of, the NTM reform program.

Food safety is increasingly becoming a significant barrier that Vietnam must overcome if it is to expand production and capitalize on the country's increasing integration into regional and global economies, especially to markets such as Australia, Japan, Korea, the EU, and the United States. However, major challenges in transitioning to higher-value agriculture remain, including:

(i) ***Limited access to information about buyers' requirements in high-value markets, and disconnection from global value chains.*** Information on substances not permitted and maximum residue level requirements in importing countries is not provided to domestic producers in a timely and effective manner. The Government of Vietnam's role of updating, guiding, and enforcing quality and safety requirements is limited due to a lack of capacity and effective mechanisms to monitor and coordinate at the central and provincial levels. The government's progress in opening new markets, especially for fruit and vegetable products, is slow due to limited capacity to provide systematic and comprehensive information with regard to both SPS and food safety hazards of such products, and solutions to control SPS and food safety with a risk-based approach, as required by importing countries.

(ii) ***Lack of a competent quality infrastructure (QI) system to ensure products conform with internationally recognized quality and safety standards.*** While the demand for QI services has increased rapidly in Vietnam, particularly for sophisticated maximum residue level testing, and certification of certain chemical and microbiological substances in fresh products, assessment services are characterized by a lack of conformity, high costs, and locations in large cities distant from farms. Vietnam does not have a national policy to coordinate and guide QI work. Therefore, there is a dearth of coordination among QI institutions to maximize efficiency and effectiveness of national QI services. Laboratory testing does not currently function as a network, and there is a lack of trust in conformity assessment services in the country vis-à-vis international conformity assessment bodies.

Box 4.2. Vietnam Trade Information Portal (VTIP)

On July 12, 2017, Vietnam launched a Trade Information Portal to make it easier for traders and investors both inside and outside Vietnam to understand and comply with regulatory requirements associated with the import and export of goods, and to help Vietnam comply with signed free trade agreements and the WTO Trade Facilitation Agreement. Major barriers to the private sector, especially for smaller firms and new market entrants to import and export, are access to information and understanding the required measures and regulatory procedures applied for foreign trade in Vietnam. The VTIP aims to help them save both time and money, reduce error, and improve transparency and transaction times. The VTIP establishment is expected to contribute to increased trade and investment as one part of the World Bank Group's efforts to help support sustainable economic growth and poverty reduction in Vietnam.

The trade portal, which is managed by the General Department of Vietnam Customs under the Ministry of Finance, is a web-based database that makes all cross-border trade regulatory information available at the stroke of a key. The information includes all laws, prohibitions, restrictions, technical standards, the entire commodity classification and tariffs, all procedures for license and permit application and clearance, copies of all forms, and plain language instructions. This includes 1,237 laws, decrees, and circulars, 402 measures, 398 procedures, and 380 forms.

The VTIP provides the business community and other stakeholders with a useful tool for finding sufficient and necessary information for the facilitation of import-export activities. Making all of Vietnam's regulatory requirements for importing and exporting available to the private sector in an easily accessible, transparent, and searchable format is a key step toward a simpler, faster, and lower-cost investment climate. The portal also provides a useful tool for legislators and policy makers to identify the complexity of current regulations and procedures when applied to commodities, and to suggest areas of modernization and simplification. The portal can then be used to monitor the process of simplification.

Source: The Vietnam Trade Information Portal.

Stricter exporter requirements, technical regulations, and inspections related to food safety and QI are becoming common in Vietnam's export markets, specifically China, Japan, Korea, and the EU. Addressing these food safety and QI issues requires coordination among a number of players. Good farm management must be exercised by farmers and closely monitored by exporters and Vietnamese government agencies. At the same time, QI institutions are expected to improve and offer more rapid and reliable services with more reasonable costs and transparent processes to value chain actors.

4.3. Coping with FDI: The Systemic Investment Response Mechanism and investor-state dispute settlement

In implementing the EVFTA and EVIPA, Vietnam should better cope with increased flows of FDI by implementing a Systemic Investment Response Mechanism (SIRM). The SIRM is an early warning mechanism to identify and manage grievances due to political risks. The SIRM can be an important tool for government to retain investors and help them expand and reinvest in the hosting countries, but it could also be an important tool to ensure the proper implementation of a statewide commitment under an international investment agreement by addressing investor-state grievances arising from the conduct of public agencies.

Resolution 50 of the Politburo of the Communist Party of Vietnam on strategy on the orientation for refinement of institutions and policies, and improvement of quality and efficiency of foreign investment cooperation until 2030, officially adopted an SIRM as follows: *"Developing a mechanism for prevention and settlement of grievances, complaints and lawsuits of investors. Improving quality and efficiency of dispute resolution and enforcement institutions. Refining the laws to efficiently resolve issues related to projects with commitments to transfer assets of foreign investors without reimbursement to the State or Vietnamese party upon termination of operation, and settlement of cases foreign investors were absent or fled during the course of their investments in Vietnam."* [22]

To address investor-state grievances that could violate international investment agreements, it was proposed that the Director General of the Foreign Investment Agency lead the SIRM task force of eight members, including representatives from the Foreign Investment Agency, Ministry of Planning and Investment, Ministry of Justice, and the Office of Government. A World Bank team and the Vietnam government have been working on an SIRM in Vietnam to implement the EU-Vietnam Investment Protection Agreement, particularly protection guarantees, such as fair and equitable treatment and protection against expropriation and discrimination. An SIRM task force team is tracking 41 cases and focusing on 14 cases that are identified as high-risk, with possible disputes (see box 4.3).

To make the SIRM official and sustainable, an amendment to the Law on Investment is being drafted and will be considered and discussed in the National Assembly in May 2020. This law is important to establish the legal grounds for the SIRM and

[22] Resolution No. 50-NQ/TW on the orientation for refinement of institutions and policies on, and improvement of quality and efficiency of foreign investment cooperation until 2030, Part III.4.

to enable the lead agency to implement international investment agreements and coordinate with other agencies to track, monitor, and resolve grievance cases.

In parallel with the new Law on Investment, it also necessary to support the drafting of a decree guiding the new regulations on the law (amendments) on the management of investor grievances and the prevention of disputes between the state and investors. This decree should govern the formation and operation of the SIRM and its organizational structure; the administrative procedures and formalities for investors to send their grievances to the agency in charge of the SIRM; and internal standards of procedure to manage and resolve cases within the government. This decree would help the lead agency to seek collaboration with its peers by direct negotiation, ranging from informal exchanges, escalating to peer pressure, and negotiations in the shadow of the law.

To make the SIRM permanent and sustainable, the internal regulations need to be amended to include the SIRM as part of the mandate and to further improve the capacity of the Inward FDI division under the Foreign Investment Agency. This will help institutionalize the SIRM to collect information, make legal and economic assessments when receiving grievances, and coordinate with other agencies.

Box 4.3. Systemic Investment Response Mechanism task force activities

As soon as the Systemic Investment Response Mechanism (SIRM) task force was created in December 2018, an internal training course was provided by the World Bank Group project team on how to identify, manage, and resolve grievance cases. The task force team and the World Bank also hosted three public training workshops on state-investor dispute prevention to provide basic knowledge on international investment agreements, including the CTTPP and EVIPA.

The World Bank Group's team and the SIRM task force have customized and developed tools to track and monitor cases and measure impacts. The focus of this work is to synchronize the tracking tool with the national FDI information system to collect relevant information more easily. The task force completed four templates, which are essential for SIRM operation: (a) a tracking tool; (b) a questionnaire for interviewing, and collecting information from, foreign investors; (c) legal and economic memos for analyzing the legal basis and the legal and economic impact of grievances for Vietnam; and (d) a report submitted to the higher-level agencies, which records information and grievances of the foreign investors, opinions of the representatives of states agencies, and their recommendations on grievance resolution.

The SIRM task force team and the World Bank Group project team conducted a public awareness-raising campaign that included publishing a leaflet to introduce the SIRM model; and holding meetings and workshops with the foreign and Vietnamese business communities in Vietnam, and with state agencies, at both the central and provincial level.

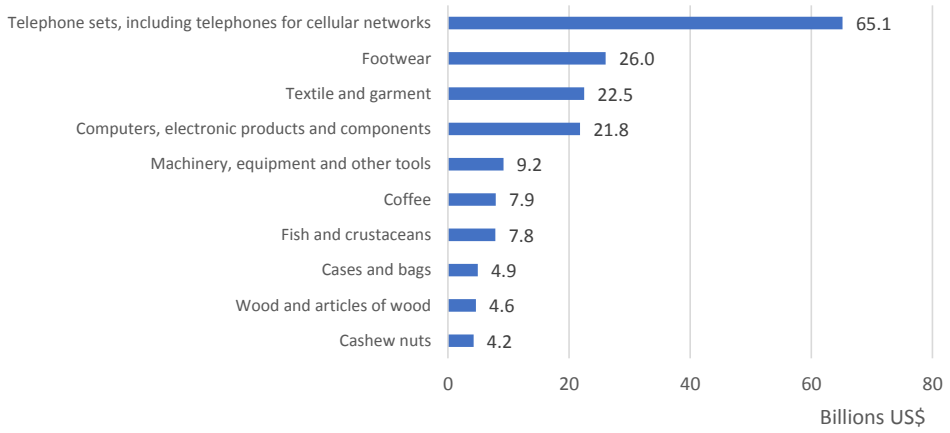
As a result of SIRM implementation, 53 grievance cases were collected from December 2018 to December 2019. After filtering out 12 grievances that did not have enough information on investors or the grievances, 41 cases were recorded with the tracking tool. The total registered capital of the original 53 projects received by the task force was US$4.3 billion, of which about US$1.2 billion has been implemented. These 53 projects employ 11,679 people. An economic analysis reveals that the 41 cases include an investment risk of US$2.5 billion and put more than 4,000 jobs at risks.

To date, one of the 41 cases, with an investment capital of US$9 million, has been resolved, resulting in the retention of 294 jobs. The remaining 40 cases are still at various stages of resolution. After reviewing the legal aspects, 24 cases were transferred to other departments of the Ministry of Planning and Investment for after-care services. Fourteen cases are considered to be more serious and problematic and need to be settled as soon as possible. There were 17 cases in the manufacturing sector.

4.4. Taking advantage of the EVFTA after COVID-19

Recovery efforts should be made in all export-oriented industries, but priority should be given to key sectors recently reported as Vietnam's top exports to the EU market in order to take advantage of EVFTA implementation. Figure 4.6 shows the top 10 exports from Vietnam to the EU market during 2014–19. Firms are the principal agents in this effort, but the government should make clear that it is a priority of the overall fiscal and financial packages that were announced to support export to the EU market. Business associations should play a critical role in facilitating the participation of firms by raising their awareness about the benefits of taking advantage of the EVFTA and provide legal guidance to help them do so.

Figure 4.6. **Top 10 exports from Vietnam to the EU market, 2014–19**



Source: Vietnam Customs.

Policy should address the COVID-19 consequences in the longer term, as well. In the longer term, the combined impacts of COVID-19 and trade tensions could lead to a deep restructuring of global value chains (GVCs). GVCs tend to be less dependent on some global production centers, such as China, paving the way for Vietnam to step in to fill the supply chain gap. Global supply chains could also be shorter, with fewer countries engaging. For some circumstances under the increasing unilateralism and bilateralism, lead firms could manage to bring all or part of their suppliers back home or to bilaterally beneficial countries. This phenomenon might create unhealthy and more severe competition at the global level. GVC structure could change toward more forward integration and less backward integration than before. This tendency could challenge countries like Vietnam that are characterized mainly by backward integration. It is, however, a window of opportunity for such countries to shift toward a more modern model leaning on trade in services. Vietnam could maximize benefits and minimize risks from this process if it can best reposition the country in the post-COVID-19 era. This requires stronger and proactive policy responses, so that Vietnam can build more sophisticated production capacity and exports toward more value-added and high-tech prioritization.

In the long term, trade facilitation is a game changer, and Vietnam is moving in the right direction, turning the COVID-19 challenges into an opportunity to stimulate appropriate reforms. Prime Minister Directive No. 11/CT-TTg dated March 4, 2020 assigning tasks and solutions to promote trade facilitation (among other things) to cope with COVID-19, is a good example. The Directive instructs implementing measures under Resolution No. 02 / NQ-CP of January 1, 2020 for improving business environment, and Decree No. 85/2019/ND-CP dated November 14, 2019 for regulating trade facilitation procedures.

Key policy actions are appropriate and include:

(i) Applying risk-based management for managing volunteer compliance and shifting to post-clearance inspections

(ii) Applying information technology in inspections of export and import goods and transits, ensuring uniform information connection between state management agencies (specialized inspection units and the General Department of Customs)

(iii) Effectively implementing the National Single Window and the ASEAN Single Window

(iv) Promoting transparency in all specialized inspection agencies by issuing a product list with Harmonized System (HS) codes assigned for specialized inspection goods

(v) Reducing logistics costs by reducing toll fees and digitalizing their collection, rationalizing trade-related transport and logistics infrastructure toward better connecting value chains, and promoting multimodality.

An effective mechanism to handle and supervise the implementation of appropriate policies formulated should be in place to improve interagency coordination for trade facilitation and global integration.

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63 Ly Thai To Street, Hanoi
Tel. (84-24) 3934 6600
Fax (84-24) 3935 0752
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Website: www.worldbank.org.vn