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# **Rules of origin, labour standards and the TPP**

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## **Abstract**

Vietnam is in a process of active negotiations to participate in Trans-Pacific Partnership (TPP) — a free trade agreement among Pacific economies, including the United States but excluding China. The negotiations are considered of high priority for Vietnam, because the likely impacts are thought to be positive. Although the negotiations have not yet been completed, the three sectors to benefit most in Vietnam include textiles, apparel and footwear. However, Vietnam may face major constraints in maximizing TPP's potential benefits due to restrictive rule of origin requirements. Furthermore, Vietnam may be obliged to improve its labour standards, for example by allowing freedom of association. The likely effects of these restrictions are quantified using a general equilibrium model.

Keywords; Vietnam, rules of origin, trade, FTA.

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## 1. Introduction

There remain many sticking points in the TPP negotiations, among them agriculture, intellectual property, services and investment.<sup>2</sup> For Vietnam, the main issue is access to the United States (US) market for textiles, apparel (clothing) and footwear. At present there are a range of tariffs limiting imports of these items from Vietnam. Should these tariffs be removed, the potential gains for Vietnam are great, so long as Vietnam can meet the rules of origin (RoO) requirements that designate where products are made.

### ‘Made in Vietnam’

What does ‘made in Vietnam’ mean, apart from a well-known brand of apparel? To prevent transshipment, all preferential trade agreements have rules of origin clauses that specify how to determine the origin of a product. In the case of apparel, the US currently requires a restrictive ‘yarn forward’ rule, while other countries are less particular. The US rule implies that yarn production, fabric production, and cutting and sewing of the finished garment all occur within the originating country. At present, perhaps 80 or 90 per cent of Vietnam’s textiles come from other countries, mostly from China and Taiwan. TPP negotiators have agreed to cumulate rules of origin across members. This means that the yarn and textiles could be produced in any member country. This is a quite significant concession by the US, which threatens its textile export industry, but it is not so helpful to Vietnam because China and Taiwan are not TPP members. With exports of \$7.6 billion in 2012, Vietnam is the second largest supplier to the American market, and competes with TPP members Malaysia, Mexico and Peru.<sup>3</sup> These last two countries, which currently have a free trade agreement with the US, favour restrictive rules of origin to prevent competition from Malaysia and Vietnam. The largest supplier is China, with exports of \$41 billion. Since China is not a member, a successful outcome to the TPP negotiations would result in significant trade diversion as Vietnamese exports replace a share of the Chinese exports.

Footwear is another contentious issue for Vietnam. The US is the biggest market for Vietnamese footwear, with exports in excess of \$2.5 billion. There are large tariffs on some footwear products, as high as 48 cent tariff.

While US textile and footwear producers and exporters with preferential access would like to maintain current restrictions, US retailers and consumers are in favour of a more liberal

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<sup>2</sup> The TPP countries are Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, the United States, and Vietnam.

<sup>3</sup> Trade data are from Comtrade in 2012, HS codes 50-63 (textiles and clothing) and 64 (footwear).

environment. Some stakeholders recommend universal rules that apply to all products and all countries. It remains to be seen how the negotiations pan out.

### **Japan's rice market**

The opening of the Japanese rice market is another unresolved issue. So far the Japanese have been reluctant to allow any additional access over that agreed in the Uruguay Round of trade negotiations that concluded in 1995. Although there have been signs that they may relent, this remains a sticking point in the negotiations. Japan recently signed a free trade agreement with Australia, another TPP member, and although Japan made concessions on beef and selected agricultural products, it gave nothing away on rice. Vietnam is a major rice exporter and may be able to take advantage of improved access if it is forthcoming.

### **Decent work for all**

Labour standards are a concern for Vietnam in the negotiations. The US has proposed that all countries accept the ILO Declaration of Fundamental Principles and Rights at Work (1998). The core principles relate to freedom of association, collective bargaining, forced labour, child labour and discrimination in employment. Vietnam does not allow organised (union) labour apart from State run unions.

Many concerns have been raised about Vietnam's labour standards and the rights of workers. The concerns include forced labour, child labour, discrimination, and the absence of freedom of association, which implies the inability to form a union. However, some of these concerns have been raised by organisations such as the US Teamster's Union whose members compete with Vietnamese labour and thus have an interest imposing strict conditions in any FTA.<sup>4</sup> The evidence on forced and child labour is by its nature anecdotal and difficult to document. The Government agency MOLISA estimates that child labour (10-14 year olds) in the workforce is 3 per cent. Some claim that forced labourers could number some 300,000 from 2000 to 2011.<sup>5</sup>

In 2013, the Vietnamese Government revised many of its labour codes, relating for example to grassroots democracy, labour disputes, licensing of labour lease, wages, working time, rest time and occupational safety and hygiene, labour contracts and units in which strikes are prohibited (ILO 2013).

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<sup>4</sup> <http://www.teamster.org/content/labor-and-human-rights-coalition-call-suspension-trade-discussion-vietnam>.

<sup>5</sup> <http://www.laborrights.org/creating-a-sweatfree-world/changing-global-trade-rules/state-sponsored-forced-labor-in-vietnam-drug->

In spite of concerns of workers' organisations in developed countries, it is difficult to find a strong relationship between labour standards and competitiveness. Signing up to ILO Conventions seems unrelated to export shares. However, Busse (2001) found that a one per cent increase in child labour was associated with a 0.43 per cent increase in ratio of unskilled-labour-intensive exports to total manufactured exports in a cross sectional study of 82 countries. Weaker union rights were also associated with an improving comparative advantage in unskilled-labour-intensive goods.

The purpose of this note is to examine some of the issues and benefits of the TPP from a Vietnamese perspective. We use a well-known general equilibrium model to quantify the potential impacts assuming a range of negotiated outcomes regarding tariff cuts and rules of origin. We also attempt to quantify the impact of the acceptance of core labour standards as requested by several developed countries in the TPP. These would raise labour costs in Vietnam, and make labour intensive products more expensive.

The results suggest that the potential annual welfare benefits for Vietnam from a liberalised TPP are around \$2.8 billion. Most of the gains accrue to the textile, clothing and footwear sectors. Restrictive rules of origin will limit these gains somewhat, depending on the scope for Vietnam producers to source yarn and textiles from TPP countries or to develop their own productive capacity. Higher labour standards will benefit some workers but make it harder for other to find meaningful employment.

## **2. The textile and apparel sector in Vietnam**

### **The process**

The production process for textiles and apparel is complicated by the diversity of products and inputs into production. Cotton, wool and silk are the natural products that can be spun into yarn, which in turn is knitted or woven into cloth, which can then be cut and sewn into apparel (clothes) or used to make home textiles such as towels, sheets and curtains. Vietnam produces silk but negligible amounts of cotton and wool. These natural products must compete with synthetic sources — polyester, nylon and acrylic — which are made from hydrocarbons.

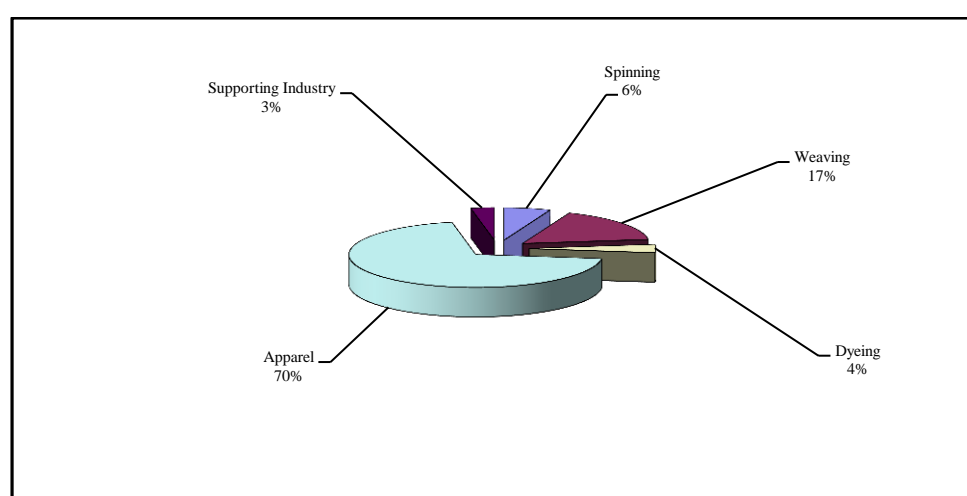
The US RoO require that the yarn must be spun in the originating country, although the cotton, wool or silk need not be grown there. Of relevance to the TPP, in Vietnam the inputs from local sources often are not adequate in quantity or quality for the production of exportable goods, and the sector is dependent on imported inputs. Vietnam is 54 per cent self-sufficient in textile production, according to GTAP data which is derived from the national accounts.<sup>6</sup> A significant proportion of inputs for garment production is imported from China. However, RoO apply at the individual product level, not to the industry as a whole. Even if half the domestic production uses imported materials, it is possible all the exports to the US meet the RoO requirements. Data at this level of disaggregation is not available.

In Vietnam, silk is used in the handicraft industry or sold directly to domestic consumers. Almost none is sold into the textile sector.

## Production

The textile and apparel sector in Vietnam contributed 8-9 per cent of industrial production between 2005 and 2012. Figure 1 shows that apparel companies dominate the sector, with upstream industries still under-developed and relying on imports. Weaving and dyeing activities require technological know-how, huge capital investment and skilled workers. Currently, investment in a weaving and dyeing factory is \$20-30 million, while that of a clothing factory is about \$50,000 to \$100,000. The dyeing activity is very polluting, requiring large costs for waste-water treatment that not all investors could afford.

**Figure 1: Textile and apparel companies by activity (per cent)**

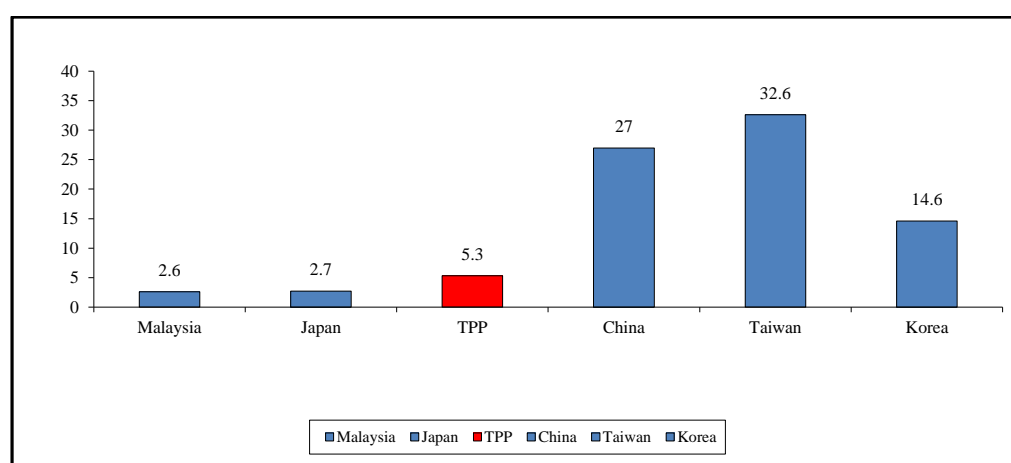


*Source: Vietnam Textile and Apparel Association (VITAS) (2013).*

Domestic production of inputs into apparel production in Vietnam is still low. Annual domestic production of yarn is 500-600 kt - but mostly of low-to-medium quality, just suitable for towels, not fabrics. Vietnam has been exporting lower-quality yarns while importing higher-quality yarns (VITAS 2013). Around 50 per cent of domestic demand is imported. In 2012, Vietnam imported 503 kt of yarn and fibre, valued at \$138 million (GSO data).

The imports of yarn and fibre from TPP member are small, just 5 per cent. Major sources are Taiwan (225 kt), followed by China and Korea (Figure ).

**Figure 2: Imported yarn and fibre by source (per cent of yarn and fibre import value)**

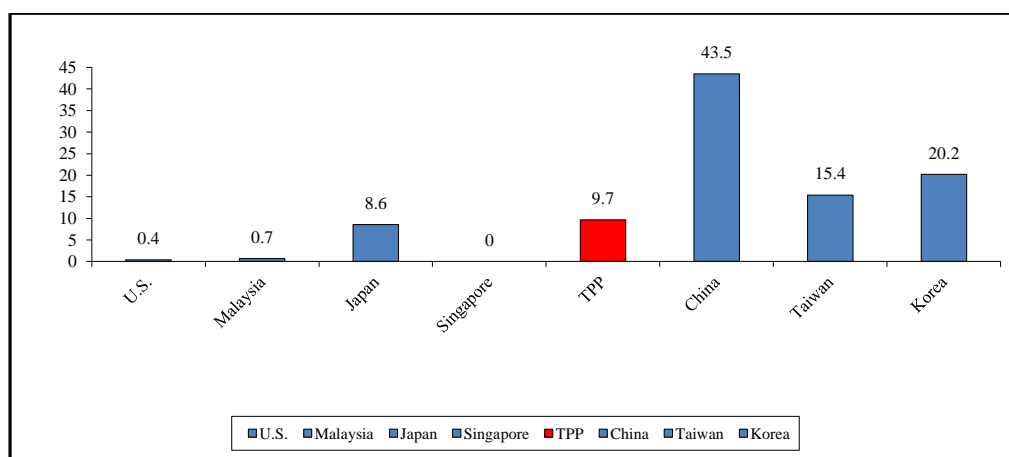


*Source: Authors' compilation from GSO data.*

Annual domestic production of fabrics is 80 kt of knitted fabrics and 700 million metres of woven fabrics of low-to-medium quality, mostly for garments sold in the domestic market. Some 180 kt of knitted fabrics (69 per cent of the demand) and 2,200 million metres of woven fabrics (76 per cent) are imported every year (VITAS 2013). China is the major supplier (figure 3). In 2012, Vietnam imported \$7 billion of all types of fabrics (6 per cent of the total merchandise import), which is very high share (GSO data).



**Figure 3: Imported fabrics by source (per cent of fabrics import value)**



*Source: Authors' compilation from GSO data.*

Dyeing and finishing activities produce 120 kt of knitted fabrics and 300 million metres of woven fabrics. Of the latter only 20-25 per cent are suitable for production of exported garments. Knitted fabrics are of slightly better quality, but far from sufficient (VITAS 2013).

Domestic production is characterised by obsolete technology and equipment, and high dependence on sub-contracts with multi-national companies in the sector.

Therefore, foreign investment is needed if Vietnam is to have sufficient upstream production to meet the RoO requirements expected in the TPP.

## Exports

A salient feature of the sector is strong export orientation. More than 80 per cent of domestic production is exported. In 2012, textile and apparel exports reached \$15 billion, contributing 13 per cent of the country's total export revenues.

TPP countries are important trading partners for Vietnam, and textiles and apparel exports to the US are very important. Some 40 per cent of Vietnam's global merchandise exports go to the other 11 TPP countries (table 1). Textiles, apparel and footwear goods comprise 31 per cent of total exports to TPP countries, and some 20 per cent of global exports are the goods to the US. A large share, 72 per cent, of apparel exports go to TPP countries, as do almost 50 per cent of textiles and 43 per cent of leather goods (table 1).

**Table 1 Vietnam exports to TPP members, 2012**

<b>Product</b>	<b>HS Chapter</b>	<b>TPP</b>	<b>World</b>	<b>Share to TPP</b>
		\$m	\$m	%
Animal	01-05	2184	5143	42
Vegetable	06-15	2441	12275	20
Food products	16-24	1140	3068	37
Minerals	25-26	130	859	15
Fuels	27-27	6240	11353	55
Chemicals	28-38	731	2216	33
Plastics and rubber	39-40	1730	5812	30
Hides and skins	41-43	761	1640	46
Wood	44-49	753	2182	35
Textiles and clothing	50-63	10656	18150	59
Footwear	64-67	3359	7746	43
Stone and glass	68-71	862	1768	49
Metals	72-83	1470	4256	35
Machinery and electronics	84-85	8276	28276	29
Transport	86-89	943	2418	39
Miscellaneous	90-99	3454	7367	47
<b>Total</b>		<b>45132</b>	<b>114529</b>	<b>39</b>

Source: Comtrade via WITS.

Major export destinations are the U.S. (\$7.5 billion, accounting for nearly half of export value of the sector (49 per cent)), EU (\$2.5 billion or 17 per cent of the export value). Japan alone is the third largest destination, making \$2.0 billion or 13 per cent of the export value) (GSO data). Vietnam becomes the second largest textile and garment exporter to the U.S., the third largest exporter to Japan and the fifth largest exporter to the EU (VITAS 2013). Vietnam now is the fifth largest textile and apparel exporter in the world.

### **Existing impediments to exports**

Average tariffs on Vietnamese exports of textiles, apparel and footwear are 11, 13 and 15 per cent respectively. Tariffs on some individual TCF exports to the US can be as high as 48 per cent. The most significant tariffs are shown in Appendix table A1. These include: 11 per cent

for jerseys, pullovers, cardigans and waistcoats (HS 611020); 8 per cent for women's or girls' trousers (HS 620462); 20 per cent for women's or girls' blouses and shirts (HS 610610); and 25 per cent for footwear with outer soles and uppers of leather (HS 640299).

## **Employment**

The textiles and clothing sector is relatively labour-intensive, generating income for 33 per cent of industrial workers in Vietnam in 2011. Most of the labour skills required are low to medium, often female, which help to create employment for a large section of the population, especially for the rural workforce, and thereby facilitating a shift from farm to non-farm activities. High labor intensity together with strong export orientation of the sector makes exports extremely important for employment creation. VITAS (2013) estimates that every \$1 billion increase in textile and apparel exports create about 150,000-200,000 jobs.

## **Government policies**

As the sector is strategic in term of exports and job creation, the Government has adopted various policies to facilitate its development.

The overall directions for the sector were announced in Development Strategy for Vietnam's Textile Industry until 2015 and orientations towards 2020. One of the most important factors accommodating realisation of the preferences provided by TPP Agreement is to create a supply chain linking businesses from spinning fabrics to design, sewing and marketing.

Most of the sector is privately owned but there is a significant State Owned Enterprise, called VINATEX. A Project on Restructuring Vietnam Textile Group (VINATEX) during the period 2013-2015 was approved in early 2013. The objective of the project is to ensure VINATEX have streamlined structure, establishing a completed supply chain from fibre to knitting, dyeing and finishing to the final garment; to enhance value added in textile and apparel production; and to improve efficiency and competitiveness of VINATEX.

To develop upstream industry, being the weakest segment in the textile – apparel sector, in 2011 the Prime Minister adopted Decision No 12/2011/QĐ-TTg on Development Policy for Selected Supporting Industries. It is emphasised in the decision that the State encourages and creates favourable conditions for organizations and individuals, both Vietnamese and foreign to invest in supporting industries though preferential access to markets, infrastructure, science and technology, human resource training, information and financing.

Textile and apparel is among the prioritised sectors, and the prioritised activities in the sector include production of natural fibre, fabric, chemicals, dyes to serve dyeing - finishing, and apparel accessories.

### **3. Methodology**

The methodology used here involves several steps. We take the GTAP version 8 data, which has a reference year of 2007, and project it forward to 2025, the year by which the TPP is expected to be fully implemented. The projection is based on expected growth in GDP, labour, capital, natural resources and productivity for each of 20 countries and regions. The next step is to model the expected removal of tariffs between all TPP countries assuming no RoO restrictions. This involves modelling the expected exemptions to the tariff cuts. These are based on existing agreements, including the US with Korea and Vietnam with Korea and Japan.

The third step involves taking account of RoO. This is done by reducing the scheduled tariff cuts according to the degree of self sufficiency of the upstream sector into production. For example, Vietnam's apparel exports to the US face a 13 per cent tariff. Because Vietnam is 54 per cent self-sufficient, the tariff is reduced by  $13 \times 0.54$ . If Vietnam produced none of its intermediate inputs, the effective tariff reduction would be zero, and there would be no additional exports.

This approach is an approximation, because we do not know the additional cost of individual firms of complying with the rules of origin. Presumably firms currently exporting to the US meet the requirements, and they could expand production using the same sources of supply. An alternative approach would be to require that any additional production destined for the US would need to source intermediate inputs from TPP countries instead of China.

The final scenario involves increasing the cost of production to meet ILO labour standards on the production of exports. This is done by introducing a one per cent increase in real wages for Vietnam. Other countries have signed up to the ILO Conventions so no costs are imposed on them. The choice of one per cent is somewhat arbitrary but the effects can be scaled up with relative accuracy.

## 4. Quantification of the impacts

### Macroeconomic effects

A TPP FTA as expected is estimated to be beneficial for Vietnam with national incomes rising by 4 to 5 per cent in 2020, when most of the tariff reductions have been implemented, and Vietnam might have got around the restrictive rules of origin. Estimated increases in trade are around 12 per cent in each direction. Welfare gains are \$3.0 billion, bearing in mind that the Vietnamese economy will have expanded greatly by then. The bulk of these gains, \$1.6 billion, come from improved terms of trade, with \$0.7 billion stemming from improvements in the way resources are allocated. The terms of trade effects result primarily from increases in the export prices of textiles, apparel and leather goods, but there are also gains in processed food and several manufacturing sectors. That most of the gains result from terms of trade effects implies that Vietnam gains from improved market access in other countries as opposed to its own reforms, although substantial gains are derived from removing tariffs in the motor vehicle sector.

This increase in welfare and trade is relatively much greater than that experienced by other TPP members (table 2). The estimated global welfare gains are \$12 billion, with \$21.6 billion accruing to member countries and minus \$10 billion in welfare losses imposed on non-members, particularly China. In other words, trade diversion is significant. Global trade increases only 0.3 per cent.

The gains to the USA are rather modest because the USA already has a rather open economy, with the exception of TCF and some agricultural products. In absolute terms, Japan stands to gain the most because of reform of its agricultural sector and improved terms of trade on its motor vehicle and manufacturing sectors. The other TPP members also gain, up to a half of one per cent of GDP. New Zealand stands to gain more, almost, two per cent, because of exports of dairy products.

**Table 2 Estimated macroeconomic impacts of TPP in 2020**

	<b>Welfare</b>	<b>Exports</b>	<b>Imports</b>
	\$m	%	%
<b>TPP members</b>			
Australia	552	1.1	2.0
New Zealand	758	2.1	3.1
Japan	12,709	1.8	2.6
Malaysia	895	1.0	1.5
Singapore	71	0.1	0.1
Viet Nam	3,015	10.6	13.2
Canada	874	1.9	1.8
United States of America	1,950	0.7	0.4
Mexico	605	1.0	1.5
Chile	116	0.2	0.3
Peru	103	3.0	7.1
<b>Non-TPP members</b>			
China	-3,831	-0.2	-0.3
Korea	-346	0.1	0.0
India	-406	-0.1	-0.2
Rest of ASEAN	-1,286	-0.1	-0.3
Latin America	-1,137	-0.2	-0.4
European Union	-2,058	0.0	-0.1
Other developed	45	0.0	-0.1
Africa	-253	-0.1	-0.2
Rest of the World	-482	0.0	-0.1
<b>Total</b>	<b>11,898</b>	<b>0.3</b>	<b>0.3</b>

Source GTAP simulation.

### Sectoral effects

The sectoral effects for Vietnam are shown in table 3. The ‘Base’ column shows the initial value of output in 2020 in the absence of any policy changes. This gives an idea of the

relative size and importance of each sector. The next column shows the estimated effects on output by sector in the TPP FTA in 2020 relative to the baseline in that year. As expected, the most striking impact is on textiles, wearing apparel and leather. Output increases by 21, 47 and 14 per cent respectively. These results are consistent with the increase in exports. This is driven in turn by increases in exports to the USA of 90, 95 and 108 per cent for textiles, apparel and leather goods respectively.

To supply the US market, Vietnam has to divert exports of textiles and apparel away from other markets. In fact, Vietnamese exports to other destination such as the EU and Japan, China and Korea decline somewhat. Another part of the adjustment process is to divert resources away from products competing for labour and capital. There are negative output effects in 17 of the 32 sectors. Some of this is a result of removing tariffs on imports of other TPP members, but some results from the increase in demand for textiles and apparel.

**Table 3 Vietnamese sectoral effects in 2020**

	<b>Base output in 2020</b>	<b>Change in output</b>	<b>Change in exports</b>	<b>Change in imports</b>
	\$m	%	%	%
Rice	14,731	-2	-2	29
Vegetables, fruit, nuts	4,211	-2	0	37
Sugar	1,427	-2	-11	23
Other crops	2,827	-4	-4	4
Forestry	3,608	-21	-25	-10
Resources	24,729	-4	-4	8
Fishing	6,266	-2	-6	1
Beef and veal	897	1	-3	4
Pork and poultry	3,629	-3	-2	46
Dairy products	776	-11	-13	16
Food products nec	10,463	-8	-7	6
Beverages & tobacco	4,033	0	2	13
Textiles	11,567	41	41	75
Wearing apparel	17,769	118	102	81
Leather	23,273	47	47	54
Electronics	6,095	-24	-20	1

Petroleum, coal products	1,173	-8	-31	2
Motor vehicle & trans equip	8,052	-12	-6	11
Wood products	5,834	-23	-17	4
Paper products, publishing	3,791	-10	-20	7
Chemical, rubber & plastics	15,766	-15	-24	7
Machinery and equipment nec	8,515	-23	-17	4
Mineral products nec	10,525	-3	-15	19
Manufactures	10,271	-16	-18	1

Source: GTAP simulation. Changes are from 2020 base.

Japan has prohibitive restrictions on imports of rice. The tariff equivalent is around 400 per cent. Removal of this tariff may lead to an increase in rice imports from Vietnam and other TPP countries. Japan currently imports mainly from Australia, the US and China, with imports of only \$7 million from Vietnam. Assuming the tariff is completely removed, simulations show a ten-fold increase in Vietnam rice exports to Japan, which, given the low base, doesn't amount to very much. However, this result is somewhat spurious for three reasons. First, the tariff is prohibitive, and reducing it by half would leave it prohibitive. It is difficult to know at what point imports would start to compete with domestic production. Second, Japanese consumers favour the Japonica variety of rice in contrast to the Indica variety grown in Vietnam and other tropical countries. Finally, the asymptotic functional form of the import equation in the GTAP model implies that where there is no trade, it is not possible to start it up regardless of the change in tariffs. This is a limitation of the model.

From a defensive perspective, removal of Vietnamese tariffs on electronics, motor vehicles, timber products, chemicals, other manufactured goods, and livestock and dairy products will increase imports from developed countries, particularly Canada and the US. The negative effects of the TPP on output are shown in the second column of table 3. These changes are quite significant, and will require some adjustment.

The TPP tariff reductions will be implemented over a period of up to ten years, and over that time the economy will double in size. This makes the adjustment process easier. For example, the electronics industry is projected to expand 122 per cent from the base period in 2007 to 2020. Under the TPP scenario the increase is only 98 per cent.



### Restrictive rules of origin on apparel exports

The impact of restricting Vietnamese apparel exports to the USA is quite significant.<sup>7</sup> If the US tariff on apparel imports from Vietnam, initially 12.75 per cent, were reduced to 5.9 per cent, or not at all, exports to the USA would be reduced as shown in table 4, with consequent impacts on total exports (of apparel) and output. The importance of the American market for GDP and real wages is also shown. The increase in GDP is two per cent less as a result. The increase in welfare is \$2,166 million and \$1,721 million rather than \$2,864 million in the liberal scenario. However, apparel exports to Japan and the EU are increased compared with the previous scenario.

**Table 4 Impact of restrictive rules of origin on Vietnamese apparel sector**

	<b>Liberal TPP</b>	<b>Restricted RoO</b>	<b>No change</b>
	%	%	
Exports	52	21	2
Exports to USA	95	32	-9
Output	47	19	1
GDP	4.5	3.2	2.5
Real wages	5.8	4.8	4.2

Source: GTAP simulation.

### Enforcement of labour standards

The possible effects of tighter labour standards are modelled by assuming a one per cent increase in the real wages of unskilled labour in Vietnam. This applies across-the board, not only for those not only those firms involved in supplying the export market. There is no increase in wages and conditions for skilled workers. The illustrative results are shown in table 5.<sup>8</sup> The main result is decrease in employment of labour by 1.2 per cent. This drives the other results. Output and exports fall by less than a half of one per cent. Real wages are increased, but household income, which includes returns from skilled labour, land and capital, falls.

<sup>7</sup> These results are dependent on assumptions concerning the cost of compliance.

<sup>8</sup> These results are illustrative because it is not known what proportion of the workforce would benefit from a rise in minimum wages, nor in which sectors they are employed. A one per cent increase is unrealistically low, but here it is applied across the whole workforce. The impacts can be scaled up in an almost linear fashion. A two per cent increase would have approximately double the estimated impacts.

Vietnam suffers a welfare loss, of \$323 million, but so do other countries, both within and beyond TPP. Global losses amount to \$432 million. This results from the higher cost of Vietnam's exports. There is no observable change in real wages in the USA, Japan or the EU.

The key to this result is the fall in employment. Employers, faced with higher labour costs, are likely to switch away from labour and use more capital and other factors. The Vietnamese Government could impose higher standards if it wished. There seems to be no advantage to signing an international agreement that obliges it to implement standards that so far are not considered appropriate.

**Table 5 Impact of increased minimum wage for unskilled labour**

	<b>Vietnam</b>
	%
Real wages (unskilled)	1.00
Output	-0.18
Exports	-0.43
Imports	-0.34
Household income	-0.30

Source: GTAP simulation.

Higher minimum wages will affect different sectors to differing degrees depending on their use of unskilled labour. From table 6 it is clear that there is a fall in output in textiles, footwear, electronics, wood products and machinery and equipment not elsewhere classified. Although primary agriculture is regarded as labour intensive, it also uses a lot of land and is therefore not so responsive to changes in the price of labour.

**Table 6 Sectoral effects of enhanced labour standards**

	<b>Change in output</b>
	%
Unskilled labour	-1.19
Paddy rice	-0.08
Cereal grains nec	0.07
Vegetables, fruit, nuts	-0.10
Sugar crops	-0.25
Plant based fibres	-0.43
Other crops	-0.26
Live ruminants	-0.26
Animal products nec	-0.22

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Raw milk	-0.46
Forestry	-0.91
Resources	-0.11
Fishing	-0.28
Processed rice	-0.07
Sugar	-0.23
Beef and veal	-0.15
Pork and poultry	-0.45
Dairy products	-0.45
Food products nec	-0.26
Beverages & tobacco	-0.30
Textiles	-0.75
Wearing apparel	-0.46
Leather	-0.75
Electronics	-0.78
Petroleum, coal products	-0.67
Motor vehicle & trans equip	-0.60
Wood products	-0.97
Chemical, rubber & plastics	-0.75
Machinery and equipment nec	-0.95
Manufactures	-0.77
Transport & communication	-0.32
Business services	-0.65
Other services	-0.34
Total	-0.39

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Source: GTAP simulation.

## 6. Implications for policy and strategy

The TPP is a more significant free trade agreement than anything Vietnam has negotiated so far. The benefits are potentially significant, but so are the costs and the risks. The gains tend to accrue to a narrow range of sectors. Furthermore, restrictive RoO may limit these potential gains.

To obtain these benefits, Vietnam will likely be obliged to open up its processed agriculture and industrial sector to imports from developed countries in the TPP, particularly the US and Canada. In addition, there are issues of Government procurement, intellectual property, State owned enterprises, foreign investment and temporary migration that have not been discussed here in any detail.

Concern about RoO may be overplayed. At present much of the yarn and textiles used in apparel production is produced outside the TPP countries. Some of these countries, Korea and Taiwan, may join the TPP in due course, although China has shown no interest.

However, a more likely option is that foreign firms set up yarn and textile production plants in Vietnam so their products can obtain access to the American market. In fact, this is happening already. Japanese, Chinese and South Korean firms are already investing in fibre production in Vietnam. In addition to access to the US market, Vietnam is seen as having low labour costs, a stable government and is a good location for sea transport. According to MOIT, \$1 billion of foreign direct investment into the Vietnamese textile and garment sector is in the pipeline.<sup>9</sup>

Concerns about labour standards may also be overplayed. While Vietnam has not yet signed all the core ILO Conventions, once signed implementation of the Conventions is generally left to the countries themselves. While there are no doubt issues with worker's rights in Vietnam, most trading partners would be agreeable to seeing some progress if not strict observance.

What should Vietnam's strategy be in the negotiations? While free trade agreements are not the first best approach to trade policy, Vietnam should take an ambitious as opposed to a defensive approach to the TPP. It should push for universal RoO that apply for all countries and all commodities. However, the US is unlikely to relent on this issue, although it has only a small textile industry to protect. Failing that, Vietnam should push for a lengthy phase-in period for RoO so that a domestic textile industry can develop. This will undoubtedly require foreign investment, which is to be welcomed. An easing of restrictions on foreign direct investment would be beneficial.

On the defensive side, Vietnam is trying to protect a raft of State owned and subsidised industries, from sugar, dairy, meat products, textiles, electronics, motor vehicles and chemicals. Such support should be removed. In fact, Vietnam should phase out tariff protection not only to TPP countries, but offer the same terms to all WTO members. This is because free trade agreements can add to existing distortions rather than remove them.

Outside trade in goods, many of the likely provisions, such as Government procurement, State owned enterprises, labour and the environment are likely to be beneficial though enhancing transparency and raising standards. One issue that needs attention is intellectual property as it relates to pharmaceutical drugs and medicines. The US is arguing for longer patents to recover the costs of development. This inhibits the growth of generic medicines

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<sup>9</sup> Vietnam Economic Times, November 2013, p.15.

and raises cost to consumers in some countries that don't currently adhere to intellectual property rules.

An important issue for Vietnam is the temporary movement of labour between countries. In particular, Vietnam would like greater scope for its workers to go to developed countries such as the US and Australia. These arrangements would likely benefit both countries, but discussions in the WTO have made no progress.

To take advantage of the TPP, Vietnam needs to implement some reforms. In spite of some progress with equitization, the economy is still weighed down with State owned enterprises, and the allocation of credit is poor due to a weak banking system, corruption and the absence of efficient capital markets.

Joining the TPP will inevitable require some structural adjustment as some industries are exposed to international competition. This will necessitate the movement of land, labour and capital to alternative uses. There is a role for government in encouraging flexibility in the movement of resources. One example is removing constraints on the amount of land designated to grow particular crops, such as rice. Another is the movement of labour from rural to urban areas.

**Table A1 Vietnam's most significant TCF exports to the United States**

HS code	Description	Exports \$m	Tariff %
<b>Apparel</b>			
610462	Women`s or girls` trousers bib and brace	129	12.6
610510	Men`s or boys` shirts of cotton knitted	135	19.7
610610	Women`s or girls` blouses shirts and	150	19.7
620193	Men`s or boys` anoraks incl. Ski jacket	179	15.16
620293	Women`s or girls` anoraks incl. Ski jackets	118	15.13
620342	Men`s or boys` trousers bib and brace	239	8.97
620413	Women`s or girls` suits of synthetic fibres	61	22.61
620462	Women`s or girls` trousers bib and brace	416	8.15
620463	Women`s or girls` trousers bib and brace	121	11.8
620520	Men`s or boys` shirts of cotton excl.	133	14.2
<b>Textiles</b>			
540752	Woven fabrics of filament yarn containing	2	17.17
550320	Staple fibres of polyesters not carded	10	4.3
590190	Tracing cloth. Prepared artist`s canvas.	7	5.55
610910	T shirts singlets and other vests	126	16.5
610990	T shirts singlets and other vests of terry	16	14.05
611020	Jerseys pullovers cardigans waistcoat	641	10.75
611030	Jerseys pullovers cardigans waistcoat	149	15.32
630260	Toilet linen and kitchen linen of terry	20	9.1
630533	Sacks and bags for the packing of goods	7	8.4
630790	Made up articles of textile materials	13	3.04
<b>Leather goods</b>			
420292	Travel bags toilet bags rucksacks	56	9.51
610610	Women`s or girls` blouses shirts and	150	19.7
620193	Men`s or boys` anoraks incl. Ski jacket	179	15.16
620462	Women`s or girls` trousers bib and brace	416	8.15
640219	Sports footwear with outer soles and uppers	28	12.36
640230	Footwear incorporating a protective met	46	25.45
640291	Footwear covering the ankle with outer	13	27.35
640299	Footwear with outer soles and uppers of	115	25.05
640330	Footwear with leather uppers made on a	128	6.15
640391	Footwear with outer soles of rubber	72	5.88
640399	Footwear with outer soles of rubber	306	6.42
640411	Sports footwear incl. Tennis shoes	32	30.99
640419	Footwear with outer soles of rubber or	10	27.98

Source: TASTE. Weighted by trade flows times average tariff.

**Table A2 Estimated impact of TPP liberalisation on Vietnam's bilateral exports with TPP members**

	Australia	New Zealand	Japan	Malaysia	Singapore	Canada	United States of	Mexico	Chile	Peru
	%	%	%	%	%	%	%	%	%	%
Paddy rice	-	-	-	-	-	-	-	-	-	-
Cereal grains nec	1	3	-74	-4	1	-1	2	-42	-6	-23
Vegetables, fruit, nuts	2	4	-15	-14	0	1	1	96	22	-12
Sugar crops	-	-	-	-	-	-	-	-	-	-
Plant based fibres	-17	-18	-13	-16	-19	-15	-16	-19	-19	-43
Other crops	3	-11	-8	-71	5	-5	2	180	43	104
Live ruminants	1	-1	-59	9	-2	-6	-6	-10	-7	-7
Animal products nec	2	-1	-8	10	5	-43	3	58	-3	-12
Raw milk	-	-	-	-	-	-	-	-	-	-
Forestry	-10	-12	-11	-9	-15	-10	-7	44	-13	-23
Resources	-5	-5	-7	30	-4	-8	-7	-11	-9	-15
Fishing	-5	-4	-5	-7	-6	-6	-6	-8	6	-8
Processed rice	1	0	959	-4	2	-5	21	-4	-6	-5
Sugar	-12	-9	112	-12	-11	-7	-11	-26	-12	-11
Beef and veal	8	7	-87	-2	3	-5	-8	-8	-3	-20
Pork and poultry	-13	-33	-83	-3	-6	-94	15	-11	-7	-22
Dairy products	-5	-27	-97	11	-13	22	-24	-23	-9	-34
Food products nec	-5	-3	-12	0	-6	-27	-3	89	18	46
Beverages & tobacco	-5	-10	11	-32	-8	54	93	-7	-7	19
Textiles	-5	-14	-11	-4	-12	156	90	394	35	109
Wearing apparel	-12	-3	-6	-10	-9	146	95	408	38	183
Leather	-9	-16	-5	-11	-11	107	98	356	35	199
Electronics	-17	-19	-13	-15	-14	-14	-8	24	40	64
Petroleum, coal products	-13	-14	-11	-14	-12	-13	-13	-14	-14	-19
Motor vehicle & trans equip	-24	-8	-1	-2	-4	22	1	100	22	-9
Wood products	-17	-16	-18	-15	-17	7	-16	123	22	76
Chemical, rubber & plastics	-11	-15	-11	-12	-13	-5	2	28	26	19
Machinery and equipment nec	-15	-16	-13	-15	-14	-9	-4	100	33	29
Manufactures	-16	-16	-16	-17	-16	0	-8	134	25	58
Transport & communication	3	3	3	3	3	2	2	3	2	4
Business services	-18	-17	-18	-18	-18	-19	-18	-18	-18	-16
Other services	-16	-15	-16	-16	-16	-17	-17	-17	-17	-14

Source: GTAP simulation. “-” refers to negligible base.

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