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Vietnam Takes on the Trans-Pacific Partnership

By Kent Hughes and Anh Nguyen

SUMMARY

The Trans-Pacific Partnership Agreement (TPP), which was signed on October 5, 2015, in Atlanta, Georgia, may significantly benefit Vietnam. Designed to stimulate trading among its 12 members—Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, the United States, and Vietnam—the TPP creates a number of opportunities for Vietnam's small but rapidly growing export-oriented economy. To realize the gains, however, Vietnam needs to develop a yarn and an apparel industry, use the TPP's phase-in for tightened drug standards to upgrade its pharmaceutical production, and make the best use of future foreign investments.

Benefits for Vietnam

Vietnam's optimistic outlook is based on the TPP's anticipated impact on Vietnam's exports. For example, the World Bank predicts that by 2030, Vietnam's export market will help to add about 8 percent to its gross domestic product (GDP). The reduction of the average 17 percent U.S. tariff on Vietnamese textiles is expected to boost these U.S. imports by 13 to 17 percent, or up to $30 billion a year by 2020. The chief Vietnamese TPP negotiator, Tran Quoc Khanh, has forecast that by 2026 Vietnam's exports will increase by $68 billion—an enormous addition to the country's $186.2 billion GDP.

TPP membership also will make Vietnam more attractive for investment. Vietnam has already attracted high-tech companies such as Samsung and Foxconn, and the TPP should help bring in more investors in for the pharmaceutical sector.

According to a leaked version of the final TPP deal, pharmaceutical firms in Vietnam and other less-developed partnership countries can temporarily produce biologics and biosimilars (medicines created with organic cells) under relaxed rules—a significant help for Vietnam, where 86 percent of patients rely on generic drugs. The Vietnam Institute of Economic and Policy research estimates that these and other advantages will raise foreign direct investment (FDI) by $13 billion. Vietnam's pharmaceutical industry overall, however, may not be competitive on the global market even under the less rigorous TPP rules. The industry is not well developed, and it has to import pharmaceutical ingredients. Under the TPP, foreign drugs can be expected to flood Vietnam and decrease domestic firms' profitability. Moreover, the TPP opens the bidding for drug production to all firms, and Vietnam's weak domestic drug companies will not be able to compete with foreign competitors.

Challenges for Vietnam

The TTP is not without some problems. One concern is that the growth of companies with 100 percent foreign ownership does not necessarily imply a bonanza for the Vietnamese economy. For example, because Vietnamese exports to Korea are products of Korean-owned firms, most of the profits will go to Korea.

The trade in textiles will be limited by a TPP rule that requires the products to be made in a TPP member country. At present, most Vietnam-made clothing uses yarn or fabric imported from China, a nonmember state. Vietnamese firms are trying to increase their own yarn-producing capacity, but the process may require years, and a short-term solution—to encourage foreign producers to open their own factories in Vietnam—again raises the question of who gets the FDI benefit.

Vietnam must also overcome certain crucial institutional challenges to create a more favorable atmosphere for economic progress. One obstacle is graft and corruption: in Vietnam, for every 1 dong of profit gained, 1.02 dong is lost to corruption. This deters investment and expansion, including ventures supported by foreign partners. For example, after a bribery scandal in which executives of a Japanese transportation consulting company pled guilty to bribing Vietnamese officials to support a railway project in Hanoi, the chief of the Japanese overseas development aid (ODA) agency that was going to fund the work threatened in early 2015 that any further case of corruption might lead to a suspension of Japanese ODA to Vietnam.

Another crucial need is to make competitive Vietnam's 3,000-plus state-owned enterprises (SOEs), which contribute about one-third of the country's GDP but are frequently mismanaged. Although SOEs are only 0.9 percent of all enterprises in Vietnam, their easy access to credit means that they account for most of Vietnam's nonperforming loans. This in turn makes banks unable to lend to small and medium-size enterprises (SMEs) and depresses Vietnam's economic growth rate. Vietnam's SOEs need to be reformed to compete with their privately owned counterparts before they can become industrial leaders and propel the economy forward.

Recommendations

Economic progress is not only critical for Vietnam: it is an important objective of America's pivot to Asia. Vietnam's agreement to create a level playing field for all firms bodes well for U.S. efforts to create a global rules-based trading system, and Vietnam's low wages bring new opportunities for American companies but will challenge domestic

U.S. manufacturing workers and firms. To achieve these goals, however, and take full advantage of the favorable conditions provided by the TPP, Vietnam must reform and strengthen its SMEs. To that end, Vietnam should take the following actions:

- Promote the establishment of private-public joint-venture companies and reverse the trend toward 100 percent foreign capital–owned firms.
- Reserve funding for supporting and promoting SMEs, similar to efforts made in Canada and Australia.
- Support the production of domestic yarn, not only to satisfy a TPP rule but also to prepare the industry for future trade agreements.
- Provide funding and other support for domestic pharmaceutical manufacturers to help make them competitive with foreign firms, and encourage pharmaceutical companies to invest in biologics, which are more complicated, provide cures for more diseases, and are often more profitable.
- Improve its standing among foreign investors by reducing graft and corruption.
- Pressure SOEs to divest from risky businesses and quicken their conversion into publicly owned companies.

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