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VIETNAM'S WTO ACCESSION AND EXPORT-LED GROWTH

Introduction

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Vietnam joined the World Trade Organization (WTO) in 2007 and became its 150th member. This accession is something of an endorsement of a long process of trade reform and international integration, which started more than two decades before in 1986 with the launch of *Doi Moi* (Renovation). Indeed, the launch of *Doi Moi* marked Vietnam's transition to a "socialist-oriented market economy" and the start of a process of trade liberalization and export-led growth. Vietnam's international integration met some initial difficulties, as the country was totally isolated at the beginning of the 1990s following the fall of the Berlin wall. After the end of the American embargo in 1994, Vietnam engaged successively in several regional and bilateral trade agreements: it joined first ASEAN (Association of South East Asian Nations) in 1997, then signed the ASEAN Free Trade Agreement (AFTA) in 2001. It also signed a bilateral trade agreement with the United States (USBTA) in 2000, which opened the US market to Vietnamese products (but with quotas). At the same time, tariff disarmament has been gradual but significant, so that following WTO accession additional trade liberalization for goods is limited: average Vietnamese consolidated tariffs will only decline from 17.4 percent in 2007 to 13.4 percent in 2019.

Vietnam's reform policy brought about remarkable results in terms of economic growth and poverty reduction. Over the last two decades (1986-2006), GDP growth has hovered around 7.5 percent per year on average and export growth nearly 20 percent per year. The strong growth posted by the Vietnamese economy has sent poverty rates tumbling since the 1990s. The overall monetary rate has been slashed from 58 percent in 1993 (first year for which poverty data are available) to 16 percent in 2006. Vietnam potentially now qualifies as a medium income country.[2] It thus joined China in the third wave of emerging Asian countries, following the East (Hong-Kong, Korea, Singapore and Taiwan) and South-East Asian (Indonesia, Malaysia, Thailand, etc.) tigers. This performance led *The Economist* to qualify Vietnam as "The other Asian miracle" with China.[3]

Vietnam's international integration and WTO accession raise three major issues, which the articles presented in this special issue try to address:

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2. The list of medium income countries is updated every year by the World Bank. With a GDP/capita of more than 1,000 dollars in 2008, Vietnam has probably joined this group in 2008 or 2009.

3. *The Economist*, title of a special issue on Vietnam, 24th April 2008.

- First, what is the contribution of international integration to GDP and income growth? Over the last two decades trade growth has been an important engine of economic growth in Vietnam. What used to be mainly an agricultural subsistence economy has now become a major exporter of agricultural and manufacturing goods. By joining WTO, Vietnam aims at deepening international integration and ensuring the sustainability of this growth path. It is therefore important to study the main characteristics of the export-led growth model followed by Vietnam and also to evaluate the macro-economic impact of WTO accession, as well as the conditions required for the expected gains to actually happen.
- What is the distributive impact of this process? Standard theory of international trade suggests that openness to trade benefits relatively more unskilled labour, which is abundant in developing countries, and which constitutes their comparative advantage in trade (Stolper Samuelson). But developing countries' experience shows that trade liberalization leads rather to increased inequalities (Goldberg and Pavcnik, 2007). This is especially the case of Vietnam, where income inequalities have increased since the 1990s, although their level is still relatively modest and much inferior to China's. As Vietnam's export-led growth is sustained by strong foreign direct investment (FDI) inflows, the distributive impact of FDI should also be studied.
- Is the export-led growth model followed by Vietnam sustainable in the long term? Two main factors might threaten this model. On the one hand, WTO reduces leeway for economic policy, all the more so as the requirements for accession become increasingly demanding. Accordingly, the State is going to lose some instruments which were used in the past to foster development, leading some to consider that policies which contributed to Asian emerging countries success are not possible to implement today (Chang, 2002). On the other hand, the emergence of China increases international competition and affects all developing countries, particularly for textile & clothing since the complete removal of quotas in 2005.

The first two papers evaluate the macro-economic and distributive impact of Vietnam's WTO accession by using computable general equilibrium models (CGE). Numerous studies have already been dedicated to this subject (Abbott *et al.*, 2009). However, contrary to these papers, previous studies are based on a very simplistic model of the Vietnamese economy, and usually make the unrealistic assumption of full employment. Moreover, these studies only evaluate the impact of tariff disarmament following WTO accession, despite the fact that this is only one aspect of WTO commitments. Last of all, because they have been conducted before Vietnam signing the WTO accession agreement, these analyses do not take into account the actual precise Vietnamese commitments but are bound to make rough hypotheses concerning the tariff reductions.

These two papers are the first to our knowledge to take into account the precise terms of the WTO agreement from the point of view of both Vietnam's trade liberalization commitments and the WTO members' commitments with regard to Vietnam. They not only evaluate the impact of the reduced tariff protection but also the additional foreign demand (improved market access) and foreign direct investment (which has not been done before). Also, they model imperfections on the labour market, which are an important characteristic of developing countries such as Vietnam where underemployment affects around one fourth of the active population.

The first paper by Houssein Boumellassa and Hugo Valin evaluates the macro-economic impact of WTO accession using MIRAGE model built by CEPII. This is a dynamic CGE model of the world economy. Labour market functioning is based on the Lewis dual model and urban unskilled wages are fixed. As rural agricultural population is still very important in this country (around half of total employment), any shock of demand from industrial or services sectors can be satisfied by recruiting rural workers without any wage pressure. The paper also takes into account the existence of duty drawbacks (see also Dimaranan *et al.*, 2005), which reduces the impact of WTO compared to other studies. Foreign direct investment is endogenous in the model. Instead of considering pre-WTO most favoured nation tariffs only, as it is usually done by existing studies, the baseline scenario includes the impact on average tariffs of free trade agreements signed by Vietnam (AFTA, USBTA, etc.). As a consequence, the simulation only evaluates the additional impact of WTO. GDP gains are estimated at +2.1 percent by 2015 when most tariff commitments are fulfilled. The end of quotas (on the American and European markets) and resulting improved market access for textile & clothing products accounts for most of the gains. China loses out for these products after Vietnam's accession because Vietnam is more competitive than China on some HS6 lines. The estimated export increase for these products amounts to 50 percent, everything being equal otherwise. Tariff reduction by Vietnam accounts for the rest of the gains. The latter effect is the only one usually taken into account by most of the studies of this kind, the latter focusing only on the gains from trade due to improved efficiency provided by removing price distortions. The paper estimates the sensitivity of the assessment outcome to the price elasticity (Armington elasticity) of world demand for Vietnam's exports. It concludes that the results depend a lot on the assumptions concerning the Armington elasticities for textile & clothing.

Jean-Pierre Cling, Mohamed Ali Marouani, Mireille Razafindrakoto, Anne-Sophie Robilliard and François Roubaud also evaluate the effect on Vietnam of WTO accession, by focusing on its distributive impact. They use a CGE model of the Vietnamese economy, coupled with a micro-simulation model based on a sample of 9,000 representative households at the national level. Individual data are drawn from the VHLSS (Vietnam Household Living Standards) survey 2004.[4] The CGE model also takes into account market imperfections for labour, by using a Phillips curve for the determination of wages. The accounting micro-simulation model makes the assumption of perfect mobility of labour within rural and urban areas but excludes the possibility of migrations from one area to another. This assumption can

4. These nationally representative surveys are inspired from the LSMS-type (Living Standard Measurement Studies) surveys promoted by the World Bank. They are conducted every other year by the General Statistics Office of Vietnam. Four VHLSS surveys have been conducted during the 2000s: 2002, 2004, 2006 and 2008 (two surveys of this kind having been previously conducted in 1993 and 1997/1998).

be justified in the short term, which corresponds to the model's term. The authors analyse three types of economic shocks they consider to be the main shocks following WTO accession: a decrease in import tariffs; an increase in demand for exports from Vietnam, due to improved market access; a rise in foreign direct investment, which increases the stock of capital of the sectors receiving additional FDI (in this case manufacturing). The first two exogenous shocks are calibrated to the shocks modeled by Boumellassa and Valin. According to the paper, real GDP increases by 3 percent following WTO accession, which is more than in the above-mentioned paper. As the structure of the two models is different, the sources of discrepancy between these results are difficult to identify: not taking into account duty drawbacks pushes the gains upwards and tends to overestimate them, while the absence of dynamics reduces the potential size of the gains. The simulations show that WTO accession has mainly four types of distributional effects: job gains, especially in the manufacturing sector; growth in real wages, especially for unskilled workers; reduction of poverty; and increase in inequalities between rural and urban areas. In each of these fields, the direction of the distributive effects found by the model is in keeping with previous trends.

Contrary to most studies which focus on the impact of trade liberalization on manufacturing, Barbara Coello investigates its impact on agriculture. Agricultural exports increased rapidly over the last few years. Vietnam became the first world exporter of cashew nuts and pepper and the second for rice and coffee. The author analyses the impact of improved market access for cash exports on agricultural incomes, using a panel drawn from the VHLSS surveys for 2002 and 2004. An agricultural trade index is constructed at the province level, measuring the average tariffs on Vietnam cash crop exports, applied by Vietnam's trade partners. She then estimates the impact of a variation of this index on agricultural incomes and concludes that improved market access contributed to increased agricultural incomes for cash crop producers. A complementary analysis based on propensity score matching techniques shows the following results: farmers who stayed in cash cropping in both years do not earn significantly more than subsistence farmers; but newcomers gain twice the average growth in agricultural income *per capita*. Coffee producers benefitted the most thanks to the increase of international prices. As it is underlined by the author, this paper has above all a retrospective interest, as after WTO accession most changes for agricultural products will be on the import side and not on the export side, and subsistence farmers are likely to be most affected. This paper is nonetheless very relevant, as it obtains in the case of agriculture the same kind of impact as the two previous papers: positive global impact of trade liberalization (but depending on the relative prices of cash crop and subsistence products and therefore of the year of study); distributive impact tending to increase inequalities between farmers.

Last of all, Jean-Raphaël Chaponnière and Jean-Pierre Cling analyse the export-led growth model followed by Vietnam. They show its successes in terms of economic and export growth but also its limits. They especially underline the fact that Vietnamese export growth has been by far the most dynamic in Asia during the 2000s (even before China), while the world market shares of major Asian exporters (Korea, Malaysia, Thailand, etc.) – except for China – have globally stagnated since the 1997 crisis. FDI played a role in these performances, to the point that foreign subsidiaries contribute to the majority of exports and employ over one million workers. Vietnam's international specialization is still characteristic of a low-income country: it exports mainly labour intensive goods (especially textile & clothing), raw materials and imports intermediate and equipment goods. In 2008, Vietnam became the second exporter of textile & clothing on the American market after China. As it is the case for developing countries following similar strategies, China's emergence is considered to be a potential threat to Vietnam export-led growth model. But the authors observe that export structures of these two countries are different. Moreover, the comparison of the evolution of textile & clothing export unit prices and market shares on the American market shows that China is not crowding out Vietnam, even since the end of quotas on this market. This conclusion is consistent with Boumellassa and Valin. In the medium term, once Vietnam has become a middle-income country, its wage costs will increase which will reduce its competitiveness compared to low income countries. It will therefore have to progressively move from textile & clothing and diversify its exports as other Asian emerging countries did before. The evolution of Vietnam's international specialization is a major challenge, which implies taking part to the regional production network coordinated by China.

To sum it up, the papers presented here bring the following answers to the questions raised at the beginning of this introduction.

- On the whole, Vietnam appears to benefit from international integration and to WTO's accession. The first data available since accession confirm the results of the papers, especially concerning the expected gains of market shares and increase of textile & clothing exports as well as the increase of FDI (at least until the international crisis). At the same time, there is a paradox due to the discrepancy between what seems to be the important gains from trade integration and the modest results of impact evaluation studies on this subject, including the ones presented here (Abbott *et al.*, 2009). In fact, the gains estimated by the papers are globally modest for two main reasons. First of all, trade brings about structural changes that are difficult to evaluate by the models which are based on the existing economic structures. For example, as remarked by Abbott *et al.* (2009), the export equations using Armington elasticities systematically underestimate the huge impact of past trade agreements which generated the emergence of new sectors. Also, most of the additional effects of WTO are difficult to quantify and therefore are not taken into account. This is a case of the liberalization of services and of the substantial reform of the law system (new laws on competition, enterprises, etc.). In the papers here, this reform is only supposed to bring more FDI but it could obviously have many other kinds of impacts such an increase in productivity and efficiency.

  The relevance of the two papers based on CGE models is therefore not so much in measuring precisely the size of trade impact but in pointing out where about the main impacts of WTO and trade policies are, and indicating the direction of impact while replacing it in a general consistent macro-economic framework. At the same time, they emphasize the key pre-conditions required for the expected gains to actually happen. Migration plays a main role in this regard, as the effective mobility of labour is necessary to allow smooth sector reallocations and adjustment between supply and demand of labour.[5] The Vietnamese government policy of migration control (*ho khau*) hinders labour geographic mobility as in China, but brings about other advantages, such as avoiding an uncontrolled urbanization process which could have severe consequences in terms of urban poverty.

- The distributive impact of international integration and WTO is significant but complex. Whereas most studies focus on the distributive impact of trade, the papers presented here also show the impact of FDI in Vietnam. Its surge reinforces regional inequalities as FDI is mostly concentrated in the economic hub of Ho Chi Minh City and the capital city Hanoi. However, contrary to what is happening in China (Wan, Lu and Chen, 2007), there is no massive increase of inequalities neither in the past nor in our simulations. The government is aware of the threat to social cohesion related to any such increase. Rather than changing the migration control policy, it has until now preferred to implement a massive redistribution policy towards the poorest regions (especially North-West) for which budget transfers represent as much as half of their GDP (World Bank, 2008). The progressive relative increase of unskilled wages is consistent with the theory of comparative advantages. But it tends to increase income inequalities between urban and rural areas, as Vietnam is still a predominantly rural country with a small number of wage workers. The differential minimum wage policy adopted in Vietnam reinforces this unskilled wage increase, as foreign subsidiaries pay a higher minimum wage than domestic firms. Nonetheless, the implementation of WTO commitments will impose the unification of minimum wage (following the "national treatment" principle) and the premium for workers in foreign firms might decrease (although the impact of this process has not been evaluated yet).
- In the medium term, the potential sustainability of the export-led growth model followed by Vietnam does not seem to be deeply affected by constraints on economic policies imposed by WTO. Agricultural export subsidies are prohibited (which is not the case for other members) but production subsidies are still allowed up to 10 percent of total production. Industrial export subsidies are also prohibited but tax reductions can still be granted to factories operating in industrial parks. The main new constraint might concern FDI policies which will have to be less directive, but the impact of this change on industrial policies has still to be evaluated. The sustainability of Vietnam's export-led growth model appears to be more related to the evolution of the relationship with China. In this respect, Vietnam is in a very specific situation compared to other Asian emerging countries. It is along with China the only country in the world which combines a one Party system lead by the Communist Party with a market economy. Apart from the huge size difference, these two countries share many other common characteristics: history, culture, etc. Because of these similarities, the trajectory of the Vietnamese economy is tightly linked to the Chinese and WTO reinforces factors of potential convergence. But this specificity also means that it is difficult to draw general lessons from Vietnam's experience that could apply to other developing countries. Besides, one cannot exclude the possibility (which is not discussed

5. This may also be the case for capital geographic mobility (which is not accounted for here).

by the papers presented here) that the international crisis might have a long term impact on the economic growth paths followed by China as well as Vietnam: let's just be reminded that the 1997 crisis provoked a drastic long term slowdown of economic growth in Asia (except for China and Vietnam).

Last of all, without changing the conclusions of these papers, the international crisis underlines an additional impact of international integration, which these papers did not take into account: that is increased vulnerability both of national economies and of the population in developing countries because of increased integration.

The serious financial crisis suffered by Vietnam in the first half of 2008, only one year after WTO accession and a few months before the international crisis happened, is an indicator of this increased vulnerability. Whereas financial liberalization induced soaring volatile capital inflows which contributed to a speculative bubble on the stock and estate markets, the end of this bubble went together with huge short term capital outflows which nearly made the country bankrupt. The drastic fall of FDI projects in 2009 (around –70 percent), which came after a huge increase between 2006 (pre-WTO) and 2008 (from 12 to 60 billion dollars) also emphasizes the danger related to relying too much on this kind of external financing. The vulnerability of people to economic crisis is also accrued by international integration: while subsistence farmers have to compete with subsidized imports from developed countries, agricultural incomes are deeply affected by fluctuations of international prices at the end of the 2000s; because of WTO, Vietnam cannot impose export quotas for rice anymore in case of drought; meanwhile, the short term impact of the international crisis on urban household living conditions almost cancels gains expected from WTO accession, especially in textile & clothing exports and employment; protectionist policies such as anti-dumping measures are easy to apply to Vietnamese products since Vietnam (like China) accessed WTO as a "non-market economy".[6]

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6. The "non-market economy" status allows another member country to evaluate the production costs of Vietnamese exports based on the current costs of another third "substitute" country, where market rules are supposed to apply. It is therefore relatively easy to apply anti-dumping rules to Vietnam: comparing its production costs to a much more developed country with much higher production costs is acceptable within WTO, in order to prove the existence of dumping by Vietnamese exporters.

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