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Economic Projections to 2020**

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DISCUSSION PAPERS IN ECONOMIC POLICY ANALYSIS

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ABSTRACT

This study presents a set of assessments of the long term economic effects of Vietnam's accession to the WTO. Generally speaking, our results indicate that Vietnam would benefit from accelerating its participation in more open multilateralism. However, it is also clear from our analysis that these benefits will remain modest in the absence of comprehensive and complementary domestic economic reforms. Passive external liberalization, even when coupled with determined domestic reform, is inferior to WTO participation combined with negotiated market access and other activist multilateral agreements. Finally, our analysis shows that capital insufficiency is a very serious constraint on Vietnamese economic growth and diversification. Capital market reform can play an essential role in dynamic and sustained economic development for the country.

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1. Introduction

Vietnam's initiative to enter the WTO has far reaching implications for its domestic economy, as well as for its place in regional and global trade. If the current offers by Vietnam are successfully negotiated in Geneva and implemented by the government, there will very substantial alignment between international and domestic prices. If WTO standards for market openness and institutional transparency are also implemented, both domestic and international economic interests can be expected to dramatically increase their commitment to accelerated and sustained economic growth in the country.

Using CNAM, the CIEM-NIAS Analytical Model of the Vietnamese economy, our estimates indicate that, while WTO accession is essential to economic modernization and fuller participation in the global economy, it is only a partial step toward realizing Vietnam's economic potential. In particular, we offer the following observations:

1. Vietnam's offer represents a substantial reduction in nominal import protection and other barriers to trade, but the gains the country could enjoy from external liberalization will be seriously limited unless they coincide with comprehensive and sustained domestic economic reform.
2. Our results indicate that the current WTO offer reduces average protection levels incompletely but substantially, and such a reduction could realize about 80% of the gains from complete removal of protection. Thus, this first phase of trade liberalization is by far the most important for the Vietnamese economy. However, the need for complementary domestic reforms is even greater if external liberalization is more gradual.
3. In the absence of other measures, the offer will lead to intensification of Vietnam's traditional comparative advantages. This would narrow the basis for development, modernization, and productivity growth, and not be in the economy's best long term interest. It can be avoided by complementary policies that promote economic diversification and negotiated external market access. Particular attention should be paid to

intensifying bilateral and regional arrangements with prominent trade partners.

4. Expansion of trade, via WTO accession and other negotiated arrangements, will not confer all its economic benefits on Vietnam unless capital markets are reformed to allow more efficient allocation of investment across the economy and greater foreign capital inflows.
5. The WTO has recently launched a fourfold initiative related to the Doha “Development Round,” emphasizing the importance for developing country of WTO policies toward Trade and Investment, Trade and Competition, Transparency in Government Procurement, and Trade Facilitation. Each of these four components is of considerable relevance to Vietnam and should be on the agenda for future discussions with the WTO Secretariat.
6. The most important insight emerging from this analysis is the essential complementarity between domestic and external economic reform. Both are necessary, but neither is sufficient, to realize the great economic potential of Vietnam. To put it another way, the effort to reform internally cannot be fully rewarded without external reform and, conversely, external reform efforts, like WTO accession, cannot be fully rewarded without commitment to complementary domestic reforms.

2. Overview of the Economic Model

This paper presents the first policy application of CNAM, the CIEM-NIAS Analytical Model, a multi-sector, dynamic applied general equilibrium model. The model is calibrated to a very detailed social accounting matrix for Vietnam, representing 97 production activities and commodities, 13 factors of production (labor and capital), 5 household types, and 94 international trading partners. Because of the high level of detail in the SAM data base, the CNAM is implemented with a flexible aggregation facility that consolidates data for more focused individual research activities. For this WTO assessment, the model has been implemented with an

aggregation of 18 sectors including sectors of importance to Vietnam at this early stage of economic modernization, including food grains, textiles, and apparel. The CNAM is fully documented in a separate report (Roland-Holst, Tarp, and van der Mensbrugghe, 2002), but the remainder of this section outlines briefly its main characteristics related to supply, demand, and policy instruments.

Production

All sectors are assumed to operate under constant returns to scale and perfect competition. Production in each sector is modeled by a series of nested CES production functions which are intended to represent the different substitution and complementarity relations across the various inputs in each sector. There are material inputs which generate the input/output table, as well as factor inputs representing value added.

Three different production archetypes are defined in the model—crops, livestock, and all other goods and services. The CES nests of the three archetypes are graphically depicted in Annex Figures A-1 through A-3. Within each production archetype, sectors will be differentiated by different input combinations (share parameters) and different substitution elasticities. The former are largely determined by base year data, and the latter are given values by the modeler.

The key feature of the crop production structure is the substitution between intensive cropping versus extensive cropping, i.e. between fertilizer and land (see Figure A-1). Livestock production captures the important role played by feed versus land, i.e. between ranch- versus range-fed production (see Figure A-2).¹ Production in the other sectors more closely matches the traditional role of capital/labor substitution, with energy introduced as an additional factor of production (see Figure A-3).

¹ Feed is represented by three agricultural commodities in the base data set: wheat, other grains, and oil seeds.

In each period, the supply of primary factors—capital, labor, and land—is usually predetermined. However, the supply of land is assumed to be sensitive to the contemporaneous price of land. Land is assumed to be partially mobile across agricultural sectors. Given the comparative static nature of the simulations which assumes a longer term horizon, both labor and capital are assumed to be perfectly mobile across sectors (though not internationally).

The current model specification has an innovation in the treatment of labor resources.² The Vietnam data set identifies two basic types of labor skills—skilled and unskilled. Under the standard specification, both types of labor are combined together in a CES bundle to form aggregate sectoral labor demand, i.e. the two types of labor skills are directly substitutable. In the new specification, a new factor of production has been inserted which we call *human capital*. It is combined with capital to form a physical *cum* human capital bundle, with an assumption that they are complements. On input, the user can specify what percentage of the skilled labor factor to allocate to the human capital factor.

Once the optimal combination of inputs is determined, sectoral output prices are calculated assuming competitive supply (zero-profit) conditions in all markets.

Consumption and closure rules

All income generated by economic activity is assumed to be distributed to a single representative household. The single consumer allocates optimally his/her disposable income among the consumer goods and saving. The consumption/saving decision is completely static: saving is treated as a “good” and its amount is

² This feature is not invoked in results reported here. Because of increased interest in labor markets and human capital in the Latin American context (see e.g. World Bank (2001)), we have developed this modeling capacity and are using it experimentally. For indications about modeling in this context, see Collado et al (1995), Maechler and Roland-Holst (1997), and van der Mensbrugge (1998).

determined simultaneously with the demands for the other goods, the price of saving being set arbitrarily equal to the average price of consumer goods.³

Government collects income taxes, indirect taxes on intermediate and final consumption, taxes on production, tariffs, and export taxes/subsidies. Aggregate government expenditures are linked to changes in real GDP. The real government deficit is exogenous. Closure therefore implies that some fiscal instrument is endogenous in order to achieve a given government deficit. The standard fiscal closure rule is that the marginal income tax rate adjusts to maintain a given government fiscal stance. For example, a reduction or elimination of tariff rates is compensated by an increase in household direct taxation, *ceteris paribus*.

The country as a whole runs a current-account surplus (deficit) that is fixed (in terms of the model numéraire). The counterpart of this imbalance is a net outflow (inflow) of capital, subtracted from (added to) the domestic flow of saving. In each period, the model equates gross investment to net saving (equal to the sum of saving by households, the net budget position of the government and foreign capital inflows). This particular closure rule implies that investment is driven by saving. The fixed trade balance implies an endogenous real exchange rate. For example, removal of tariffs which induces increased demand for imports is compensated by increasing exports which is achieved through a real depreciation.

Foreign Trade

Trade is modeled with an extended differentiated product specification. The basic assumption in LINKAGE is that imports originating from different trade partners are imperfect substitutes (see Figure A-4). Therefore total import demand for each good is allocated across trading partners according to the relationship between their relative prices. This model of import behavior is commonly referred to as the

³ The demand system used here is a version of the Extended Linear Expenditure System (ELES) which was first developed by Lluch (1973). The formulation of the ELES used in LINKAGE is based on atemporal maximization—see Howe (1975). In this formulation, the marginal propensity to save out of supernumerary income is constant and independent of the rate of reproduction of capital.

Armington⁴ specification, and it is implemented using two CES nests. At the top nest, domestic agents choose the optimal combination of the domestic good and an aggregate import good consistent with the agent's preference function. At the second nest, agents optimally allocate demand for the aggregate import good across the range of trading partners.

The bilateral supply of exports is specified in parallel fashion using a nesting of constant-elasticity-of-transformation (CET) functions. At the top level, domestic suppliers optimally allocate aggregate supply across the domestic market and the aggregate export market. At the second level, aggregate export supply is optimally allocated across export markets as a function of relative prices.⁵

Trade variables are fully bilateral and include both export and import taxes/subsidies. Trade and transport margins are also included; therefore world prices reflect the difference between FOB and CIF pricing.

Prices

The CNEM model is fully homogeneous in prices, i.e. only relative prices are identified in the equilibrium solution. The price of a single good, or of a basket of goods, is arbitrarily chosen as the anchor to the price system. The aggregate real GDP deflator has been chosen as the numéraire, and is set to 1.

Elasticities

Production elasticities are relatively standard and are available from the authors. Aggregate labor and capital supplies are fixed, and within each economy they are perfectly mobile across sectors.

⁴ See Armington, 1969 and compare, e.g. de Melo and Robinson (1989).

⁵ A theoretical analysis of this trade specification can be found in de Melo and Robinson (1989).

*Equivalent Variation Aggregate National Income*⁶

Aggregate income gains and/or losses summarize the extent to which trade distortions constrain growth prospects and the ability of economies to use the gains to help those whose income could potentially decline.

Real income is summarized by Hicksian equivalent variation (EV). This represents the income consumers would be willing to forego to achieve post-reform well-being (u^p) compared to baseline well-being (u^b) at baseline prices (p^b):

$$EV = E(p^b, u^p) - E(p^b, u^b)$$

where E represents the expenditure function to achieve utility level u given a vector of prices p (the b superscript represents baseline levels, and p the post-reform levels). The model uses the extended linear expenditure system (ELES), which incorporates savings in the consumer's utility function. See Lluch (1973) and Howe (1975). The ELES expenditure function is easy to evaluate at each point in time.⁷ (Unlike the OECD treatment of EV , we use baseline prices in each year rather than base year prices. See Burniaux et al. (1993)). The discounted real income uses the following formula:

$$CEV = \sum_{t=2005}^{2015} \beta^{(t-2004)} EV_t^a / \sum_{t=2005}^{2015} \beta^{(t-2004)} Y_t^d$$

where CEV is the cumulative measure of real income (as a percent of baseline income), β is the discount factor (equal to $1/(1+r)$ where r is the subjective discount rate), Y^d is real disposable income, and EV^a is adjusted equivalent variation. The adjustment to EV extracts the component measuring the contribution of household saving, since this represents future consumption. Without the adjustment, the EV measure would be double counting. The saving component is included in the EV evaluation for the terminal year.

⁶ This feature of the model was not used in generating the Vietnamese results presented in this paper.

⁷ Unlike the OECD treatment of EV , we use baseline prices in each year rather than base year prices. See Burniaux et al. (1993).

Specification of Endogenous Productivity Growth

Productivity in manufacturing and services is the sum of three components:

- a uniform factor used as an instrument to target GDP growth in the baseline simulation
- a sector-specific fixed shifter which allows for relative differentials across sectors (for example, manufacturing productivity two percentage points higher than productivity in the services sectors)
- a component linked to sectoral openness as measured by the export-to-output ratio

The latter takes the following functional form:

$$(1) \quad \gamma_i^e = \chi_i^0 \left(\frac{E_i}{X_i} \right)^\eta$$

where γ^e is the growth in sectoral productivity due to the change in openness, χ^0 is a calibrated parameter, E and X represent respectively sectoral export and output, and η is the elasticity. The parameter χ^0 has been calibrated so that (on average) openness determines roughly 40 percent of productivity growth in the baseline simulation, and the elasticity has been set to 1.

In agriculture, productivity is fixed in the baseline, set to 2.5 percent per annum in most developing countries (based on estimates in Martin and Mitra, 19xx). However, a share of the fixed productivity is attributed to openness, using equation (1).

In the baseline, GDP growth is given. Agricultural productivity is similarly given, and equation (1) is simply used to calibrate the shift parameter, χ^0 , so that a share of agricultural productivity is determined by sectoral openness. Average productivity in the manufacturing and services sectors is endogenous and is calibrated in the baseline to achieve the given GDP growth target. The economy-wide (excluding agriculture) productivity parameter is endogenous. Equation (1) is used to

calibrate the same χ^0 parameter, under the assumption that some share of sectoral productivity is determined by openness, for example 40 percent.

In policy simulations, the economy-wide productivity factor, along with other exogenous productivity factors (sector-specific shifters) are held fixed, but the openness-related part of productivity is endogenous and responds to changes in the sectoral export-to-output ratio. In the manufacturing and services sectors, the elasticity is set at 1. In the agricultural sectors it is set to 0.5.

Say sectoral productivity is 2.5 percent, and that 40 percent of it can be explained by openness, i.e. 1.0 percent, with the residual 1.5 percent explained by other factors. Assume sectoral openness increases by 10 percent. If the elasticity is 1, this implies that the openness-related productivity component will increase to 1.1 percent and total sectoral productivity will increase to 2.6 percent (implying that the total sectoral productivity increases by 4 percent with respect to the 10 percent increase in sectoral openness).

3. Scenarios and Results

After specification and construction, the CIEM-NIAS model was first calibrated to a baseline time trend for the period 2000-2020. This means the model was calibrated statically to the 1999 Vietnam social accounting matrix (SAM) and then run forward annually at growth rates corresponding to Business as Usual (BaU) consensus real GDP growth forecasts for Vietnam.⁸ This time path was then used as a baseline for dynamic counterfactuals of five different types.

3.1. WTO

In this scenario, it is assumed that Vietnam's current offer to the WTO is accepted, the country joins the organization and conforms to these commitments, but the domestic economy is not reformed and Vietnam remains on BaU trends for productivity growth. In this case the benefits of fuller participation in the international

⁸ The latter estimates we obtained as averages from IMF, DRI, and Oxford Econometrics.

economy are severely limited by the economy's inability to adjust to new market realities. International prices are transmitted more efficiently to domestic institutions, but structural rigidities prevent resource reallocation and structural adjustment to develop the economy's relative strengths and defer less efficient production to foreign sources.

3.2. *WTO+Reform*

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

3.3. *Parallel Trade Agreements: Vietnam-U.S. BTA (VNUS)*

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

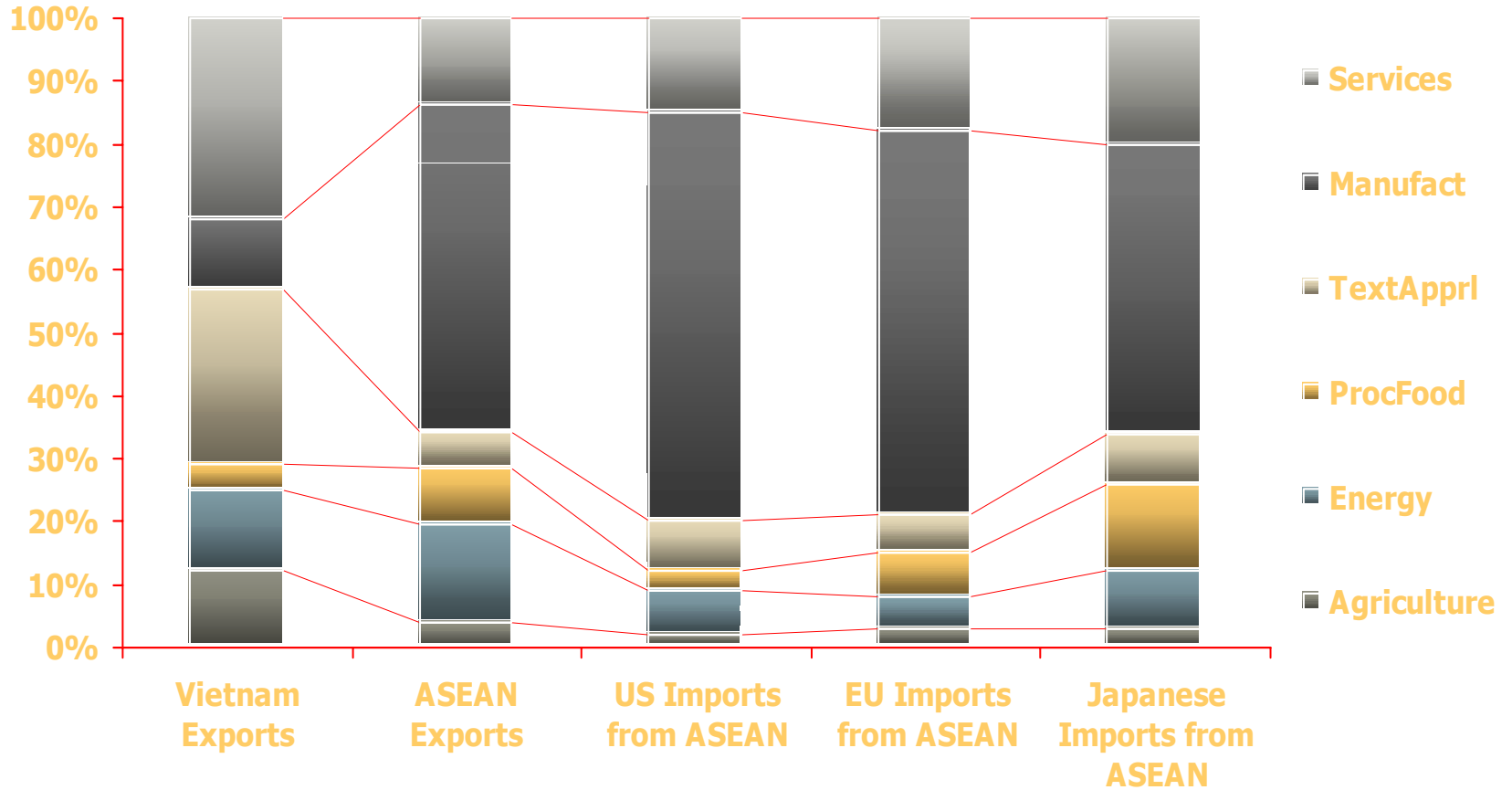
The following diagram shows the sectoral composition of Vietnamese exports in the 1999 base year. This reveals an unreasonably high dependence upon the Textile and Apparel (particularly, at the more detailed level, leather goods and footwear).

Likewise, exports from sectors of more natural comparative advantage, like agriculture, and desirable “modernization” exports like Manufactures, are too small a share of total outflows. This is a prime example of the notorious “low wage trap” that awaits countries opening trade from a comparative advantage in low wage products.

Looking more closely at this trade composition graph, Vietnam’s current export patterns are not representative of the ASEAN region as a whole, nor do they fully exploit the diversity of import demand by the world’s leading economies. It could be argued that they represent an earlier stage of economic development than the average ASEAN level, with greater reliance on labor intensive and low skilled (low wage) agriculture, textiles and apparel, and services. More importantly, demand patterns from ASEAN’s largest trade partners offer more diversified opportunities, and Vietnam could benefit by shifting its production capacity in the direction of these large markets. It is certainly reasonable to expect that the Vietnam-US BTA will stimulate export growth and diversification for Vietnam

Export and Import Composition by Partner

(1999 Baseline Data)



3.4. Capital Market Liberalization - FDI

One of the most chronic constraints on economic modernization, diversification, and productivity/wage growth in developing countries is capital scarcity. By definition, low income countries are saving constrained, developing countries have low levels of installed infrastructure, and technology levels tend to be below global averages. For all these reasons, capital insufficiency can slow the rate of aggregate growth, the scope of diversification, and reduce rates of productivity/wage growth. For resource-rich countries like Vietnam, however, there are many possibilities for investment partnership with more capital-rich countries. These arrangements create win-win situations where the FDI recipient country enjoys more extensive economic diversification, technology assimilation, and more rapid growth of output, productivity, and wages from the same resource base.

To see the potential benefits of such an arrangement, we defined an FDI scenario, which allows inbound foreign investment to Vietnam to grow at twice the rate of real GDP growth over the period 2000-2020. Given the low current levels of FDI in the country, and by comparison to Asian growth economy standards, this is a relatively conservative scenario.

4. Results and Analysis

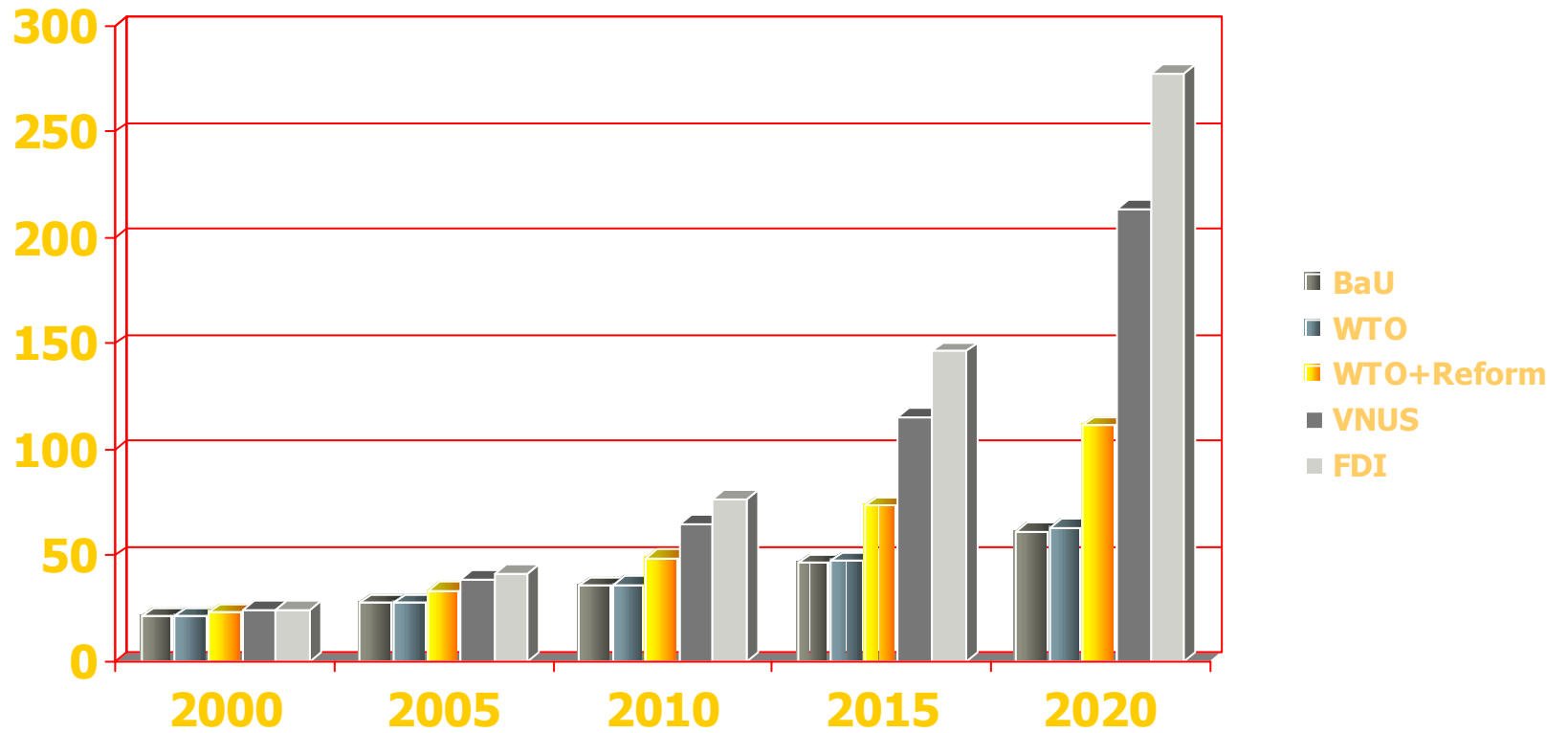
Macroeconomic effects of the five scenarios are represented in the next figure, which displays projected Vietnamese real GDP in 2020 (this and all economic data represented in trillions of constant 1999 VND). In terms of aggregate growth effects, these scenarios clearly fall into three general categories: low, moderate, and high. The Business as Usual (BaU) scenario holds to consensus growth rates averaging 2-4% over the period 2000-2020. It is rather striking that the WTO scenario makes only a marginal improvement on this, but this fact reveals something important about the realities of global market participation – economic readiness. If the Vietnamese economy were to passively open itself to external markets, without at the same time committing to the reforms needed to enable domestic institutions to capture the opportunities globalization presents, most of the benefits would accrue to Vietnam's

trading partners. This condition resembles the experience of some post-colonial economies, in Africa and elsewhere. They lacked the intuitional strength or sophistication after independence to be equal partners in trade-based economic development. The result of this was net resource transfers to their trade partners and chronically low investments in human and nonhuman capital. The experience of dynamic Asian economies was very different, largely because their governments made serious commitments to readiness in terms of market reform, institutional modernization, education, and infrastructure development.

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

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

Trade and Economic Growth: Real GDP to 2020



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

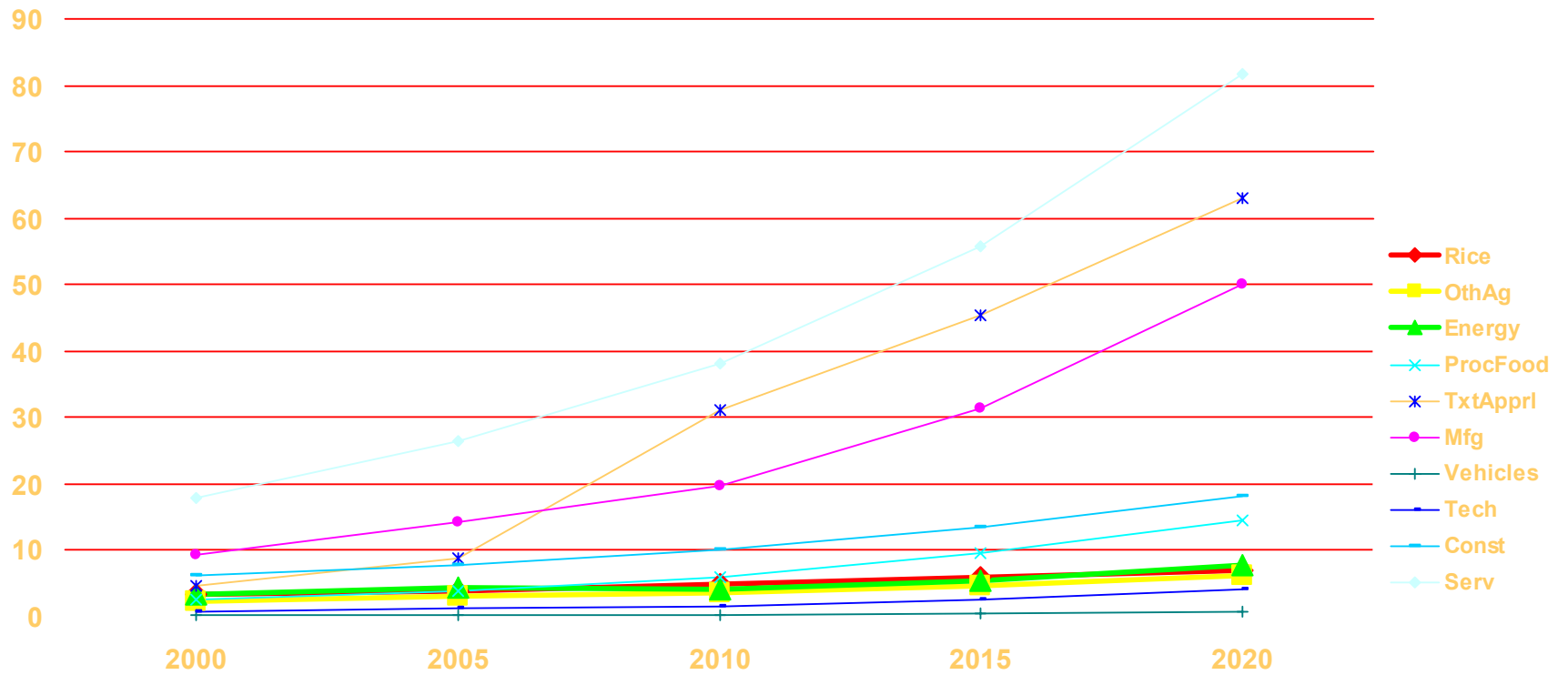
In the last scenario, we assume the government commits to the domestic and external capital market reforms necessary to increase direct foreign investment at twice the rate of real GDP growth over the next two decades. In the experience of other East Asian economies, this is a very modest expectation,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

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

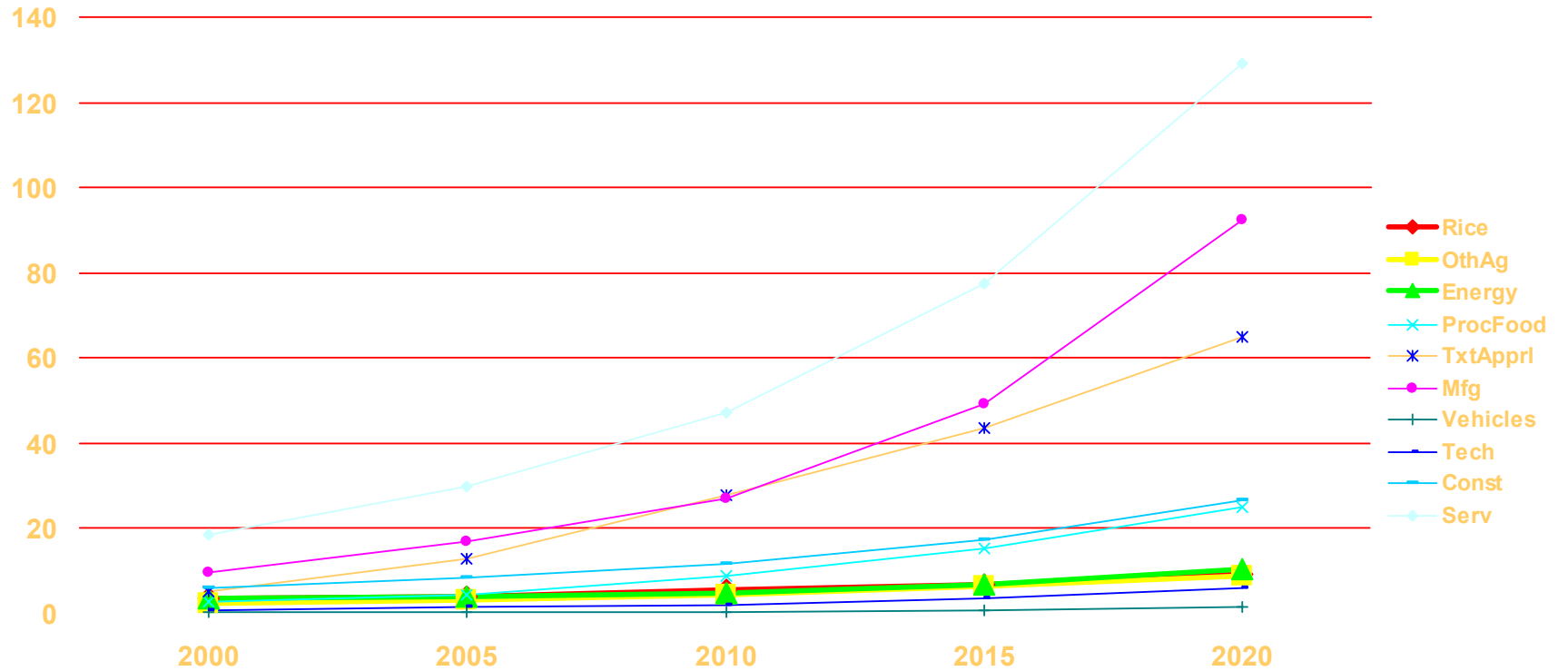
and foreign investment leads to intensification of Vietnam's traditional comparative advantage in low wage, resource intensive production.

Contrast this with the sectoral results for VNUS and FDI. In the VNUS case, greater external demand stimulates both real GDP and Service sector output more than under WTO+Reform. At the same time, more diverse export demand induces faster expansion of higher-wage manufacturing, with Textile Apparel Growth falling into third place. The main constraint now is on investment in the more capital intensive high wage manufacturing. This is alleviated in the FDI scenario, and the results are striking. Now Manufacturing is growth nearly as fast as lower wage Services, and Textiles and Apparel have fallen to fourth place behind Construction. The CNAM model unfortunately does not capture the productivity gains of this more rapid expansion in infrastructure, but we know this makes an essential contribution to dynamic growth in all developing countries. Closer inspection of the trend lines in these three scenarios also reveals that, under FDI, output expansion is not only greater by 2020, but accelerating faster. This is consistent with the argument that human and nonhuman capital accumulation is the accelerator behind dynamic Asian growth.

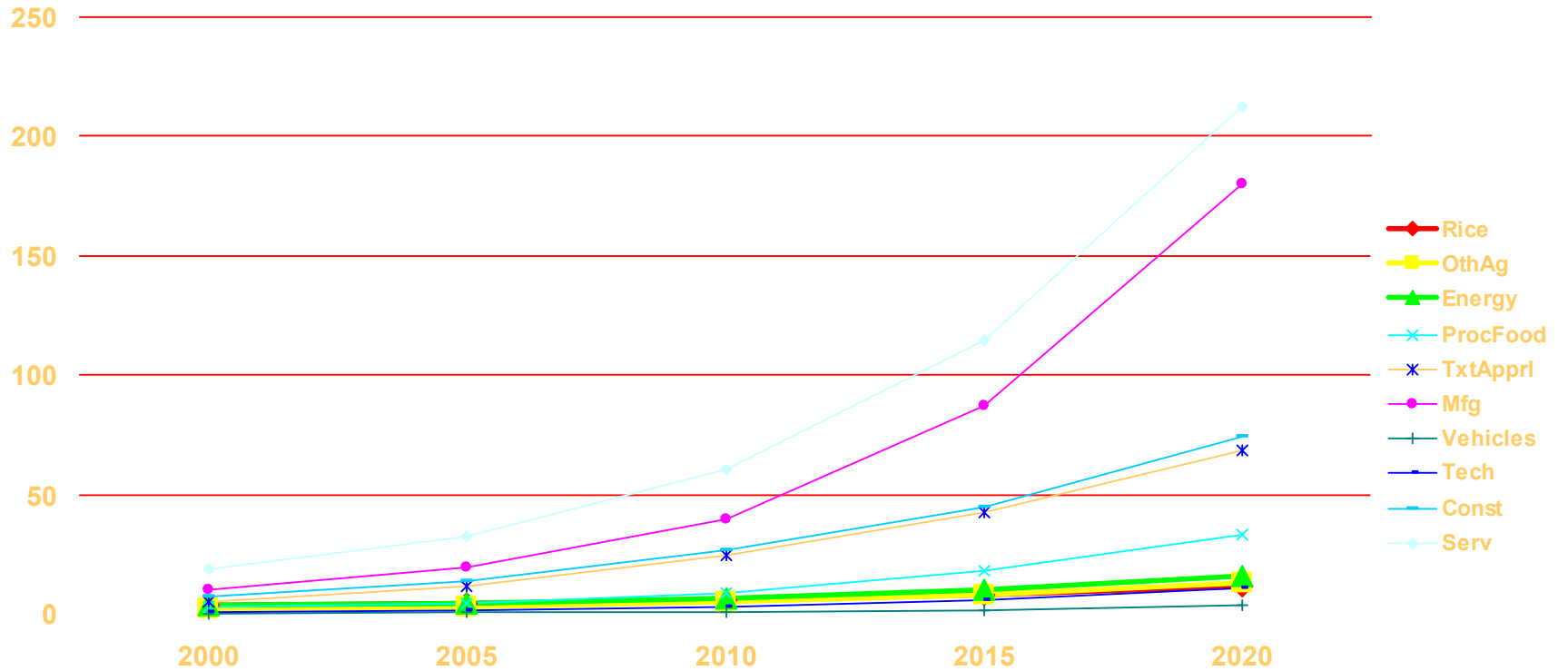
Sectoral Output Trends: WTO+Reform



Sectoral Output Trends: VNUS



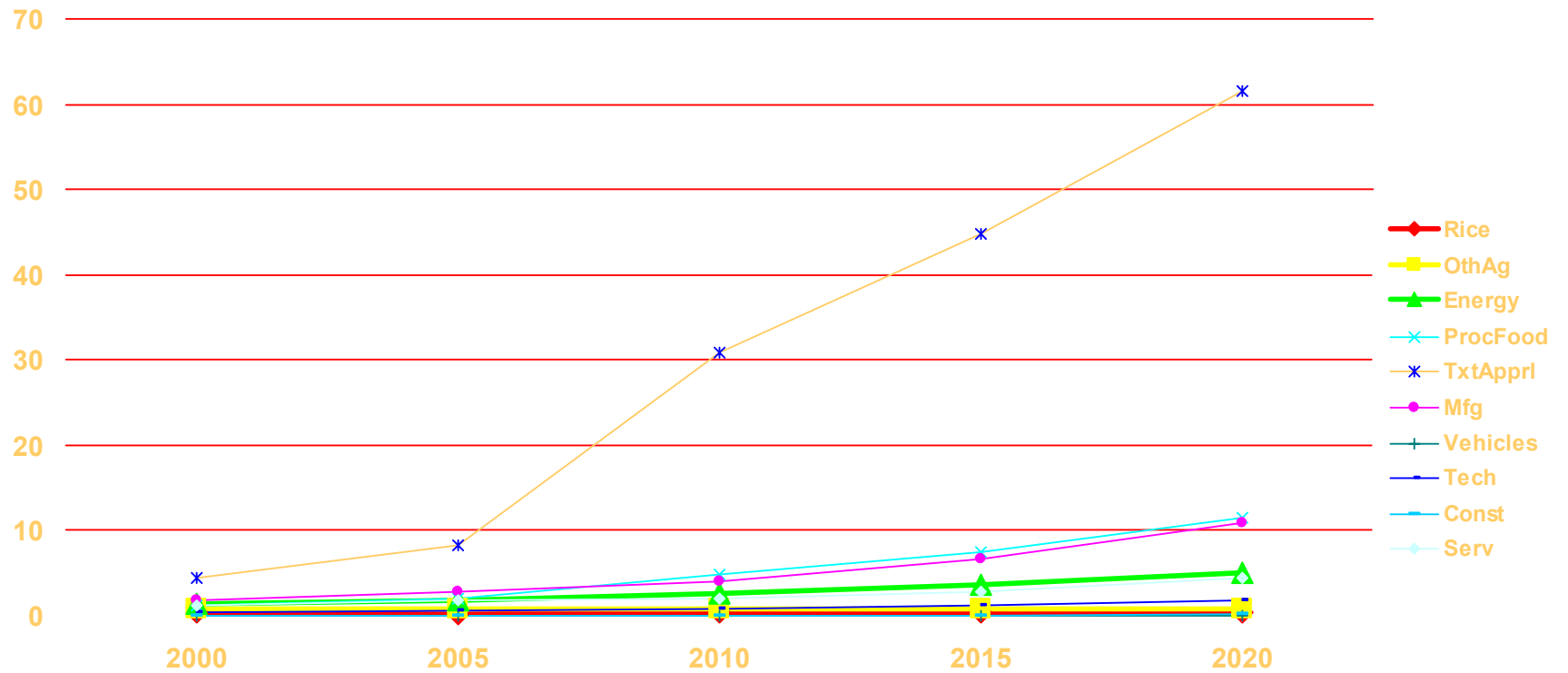
Sectoral Output Trends: FDI



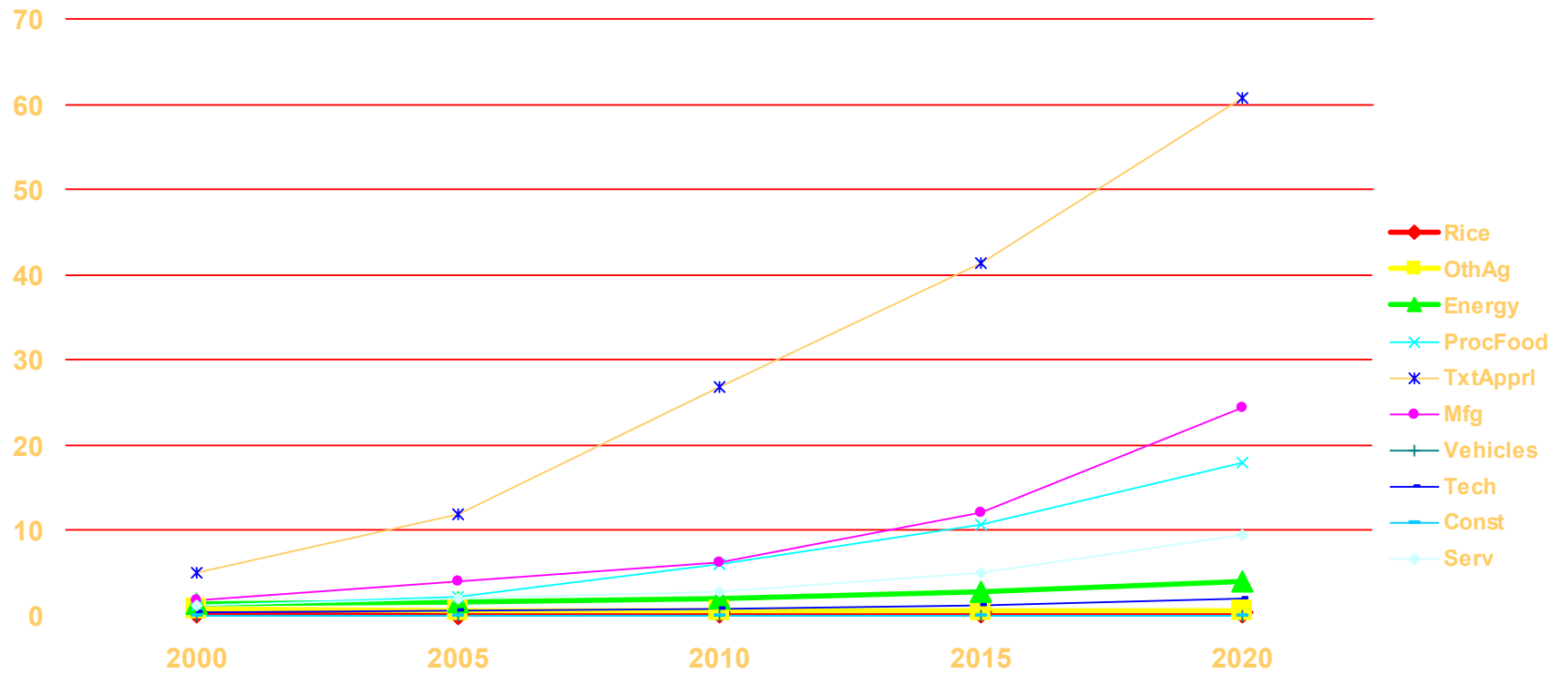
The next three figures show how the composition of exports changes under the same three scenarios, revealing the role of external demand in the macro and domestic output results. In the first diagram, the low-wage trap is very obvious. Vietnamese export expansion is dominated by Textiles and Apparel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

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

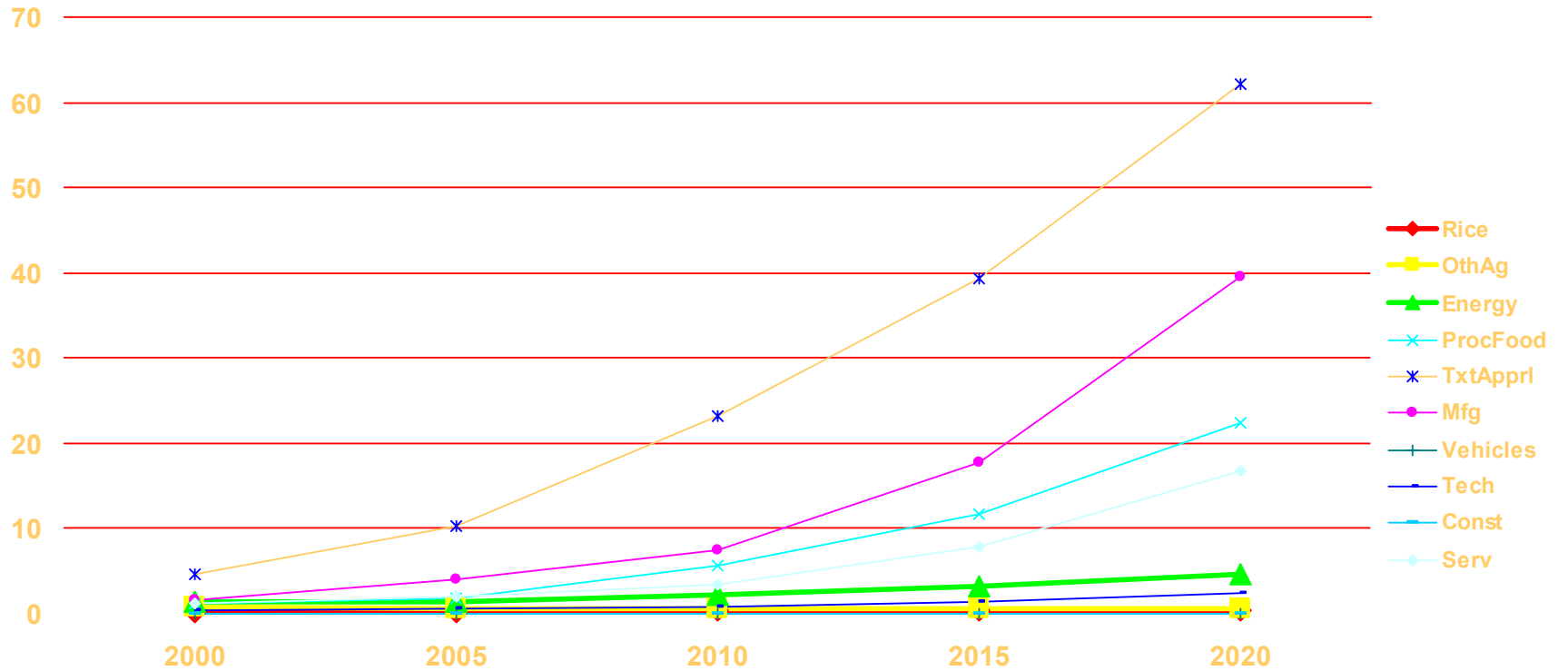
Sectoral Export Trends: WTO+Reform



Sectoral Export Trends: VNUS



Sectoral Export Trends: FDI



5. Related Policy Issues and Negotiating Agendas

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

5.1. *Agricultural Market Access*

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

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

5.2. *Intellectual Property: IT and Pharmaceuticals*

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

re-examine and even re-negotiate elements of some BTAs that may be out of conformity with WTO exemptions in this area.

5.3. *Four WTO Priorities for Advancing Trade Opportunities in Developing Countries*

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

5.3.1. *Trade and Investment*

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

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

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

5.3.2. *Trade and Competition*

The Trade and Competition component of WTO policy toward the Doha Round is intended to explicitly account for the linkages between external and

domestic economic reform. It has already been made clear how important this consideration is for accelerating and sustaining Vietnamese growth, so it would be advisable for the Vietnamese negotiators to participate actively in dialogue with the WTO Secretariat on this issue.

5.3.3. Transparency in Government Procurement

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

5.3.4. Trade Facilitation

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

5.4. Bilateral agreements with OECD countries

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

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

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

❖ *EU-Vietnam*

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

❖ *Korea-Vietnam*

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

❖ ***Japan-Vietnam***

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

❖ ***US-Vietnam***

This BTA has only recently been enacted into law in the United States, but it already needs to be taken back to the negotiating table, particularly in light of the post-Doha approach to TRIPS, but also to establish and maintain continuing dialogue with this important trading partner.

5.5. *Bilateral Trade Agreements with Prominent non-OECD Partners*

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

❖ ***China-Vietnam BTA***

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

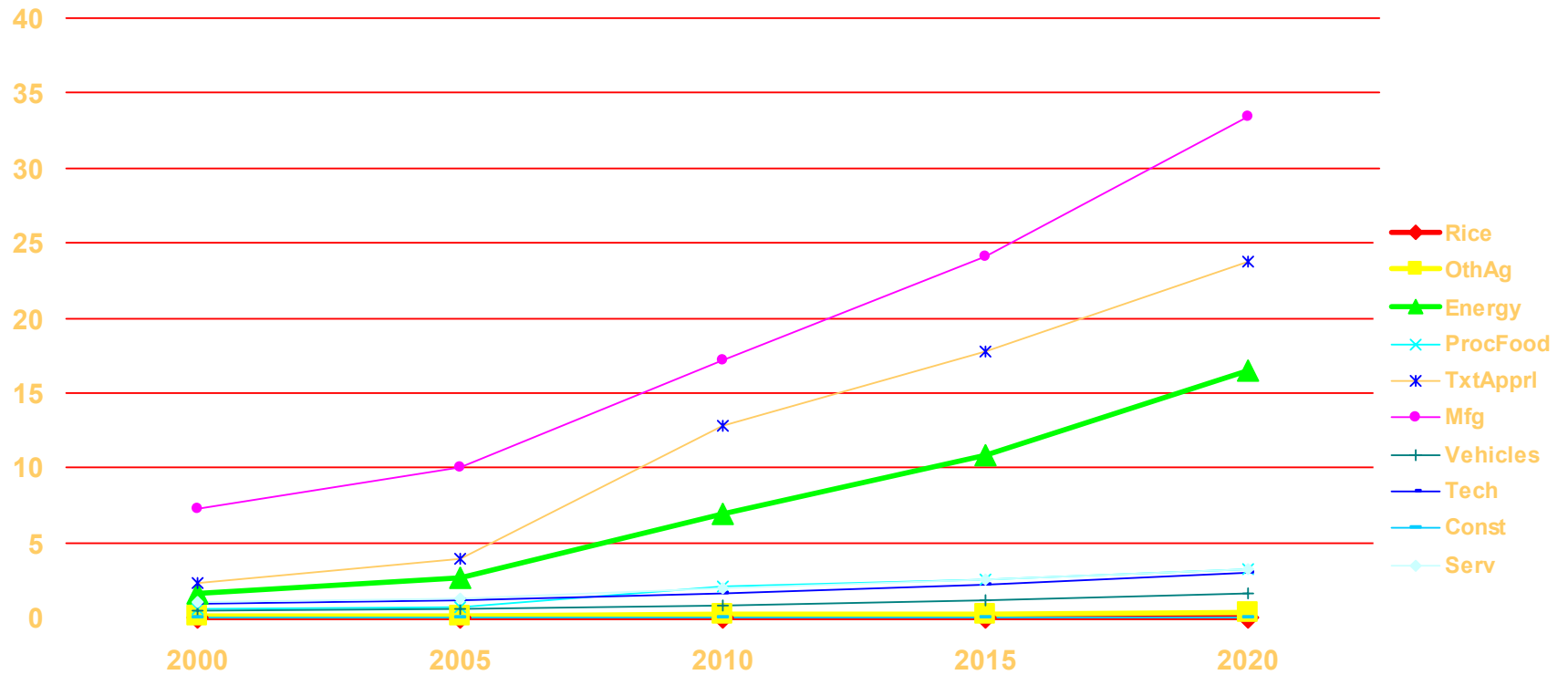
❖ *Vietnam in ASEAN*

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

5.6. *Trade Composition*

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

Sectoral Import Trends: WTO+Reform

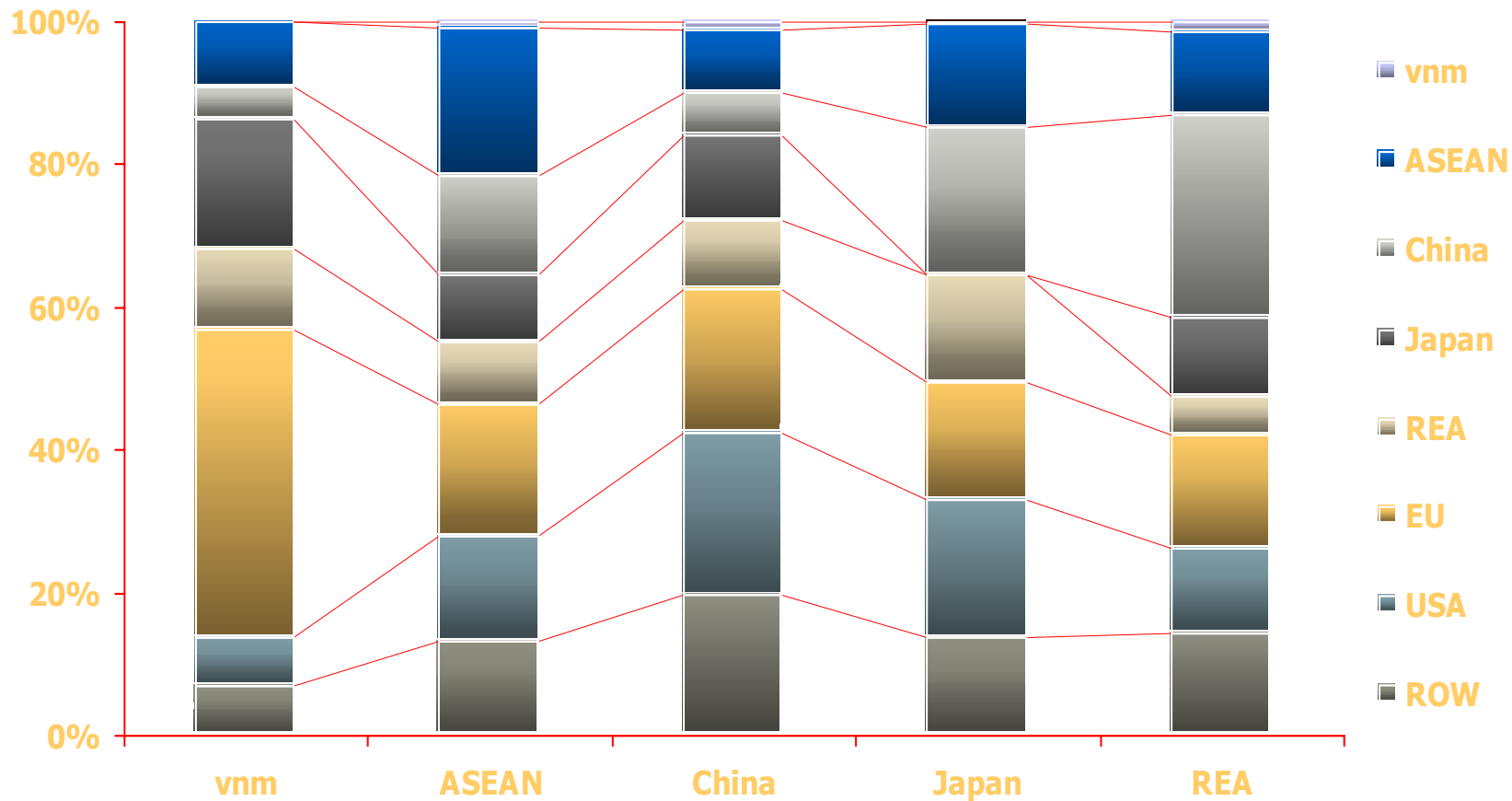


To overcome excessive specialization, we have seen that two policy areas in particular need to be emphasized: Foreign and Investment and Parallel Negotiations. Foreign Direct Investment will be essential to expand, diversify, and modernize Vietnamese production capacity, for both the domestic and external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

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

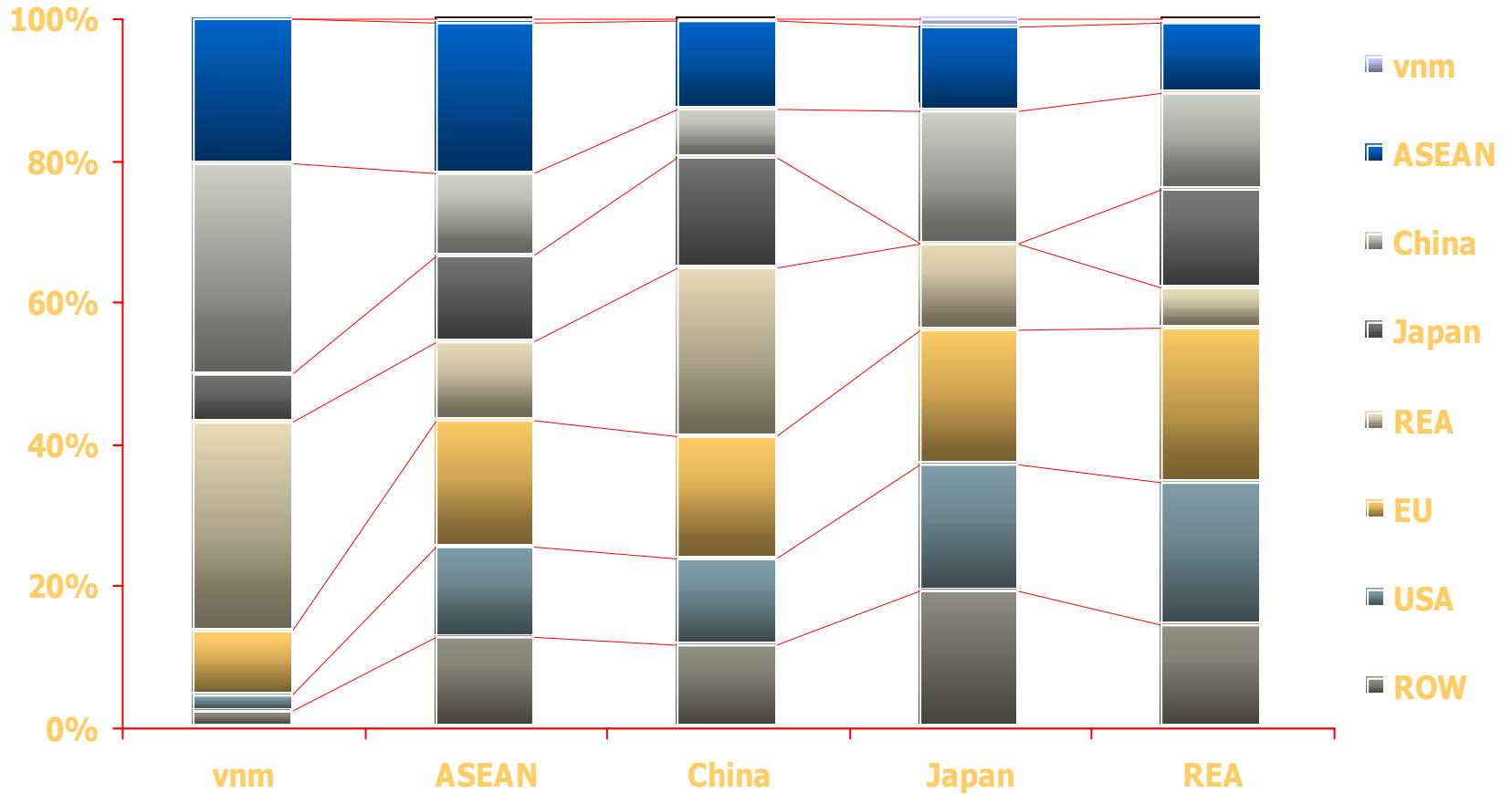
Direction of Trade: Exports by Destination

(WTO+Reform, projections to 2020)



Direction of Trade: Imports by Origin

(WTO+Reform, Projections to 2020)



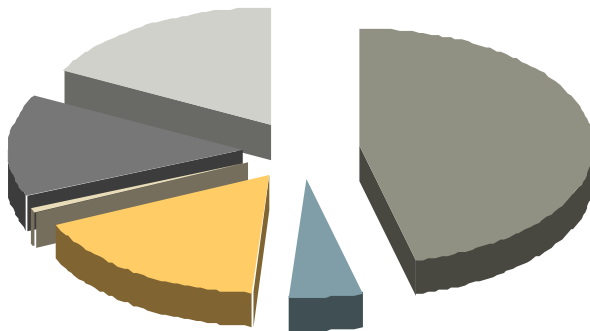
6. Scope for Trade-based Economic Expansion

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

To give a more tangible sense of the real and potential importance of trade to ASEAN economies, and what this infers about Vietnam, the last diagram contrasts Vietnam's GDP, Total Exports, and Population with that of other ASEAN partners in the 1999 base year of the model. It is readily apparent from this that Vietnam is far from its potential, both in terms of total economic activity and participation in the world economy. That trade can make a dramatic contribution is obvious from the case of Singapore, which is tiny in terms of regional population but huge in terms of trade and GDP.

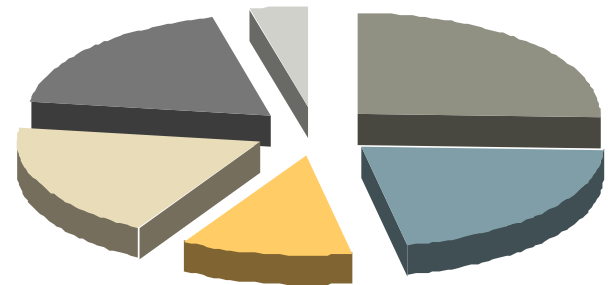
Human Resources, Trade, and Development

Population

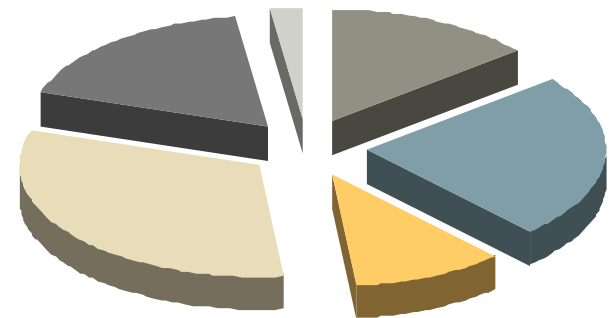


- Indonesia
- Malaysia
- Philippines
- Singapore
- Thailand
- Vietnam

GDP



Exports



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8. Annex CNAM Figures

Figure A-1: Nested structure of crop production

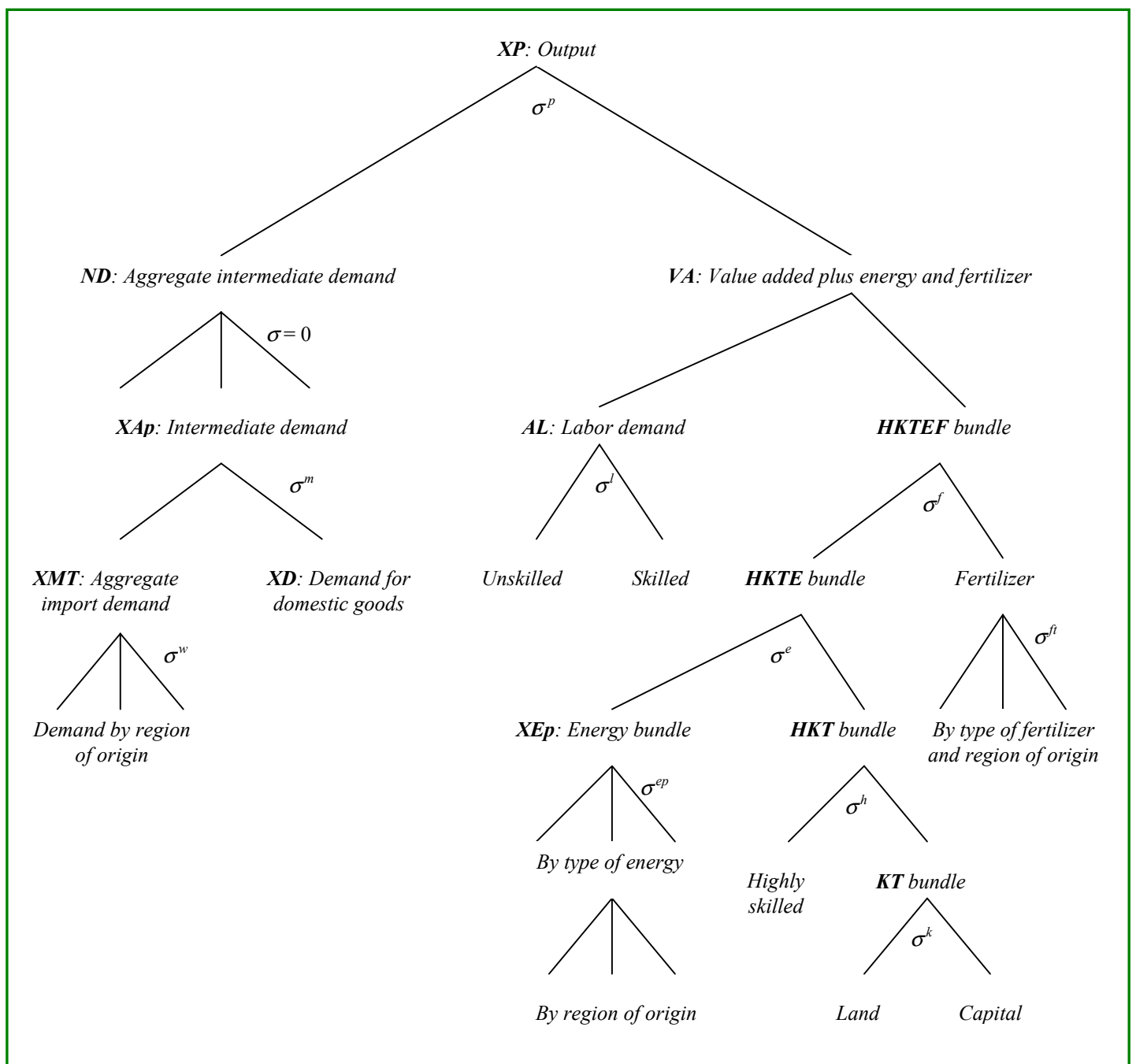


Figure A-2: Nested structure of livestock production

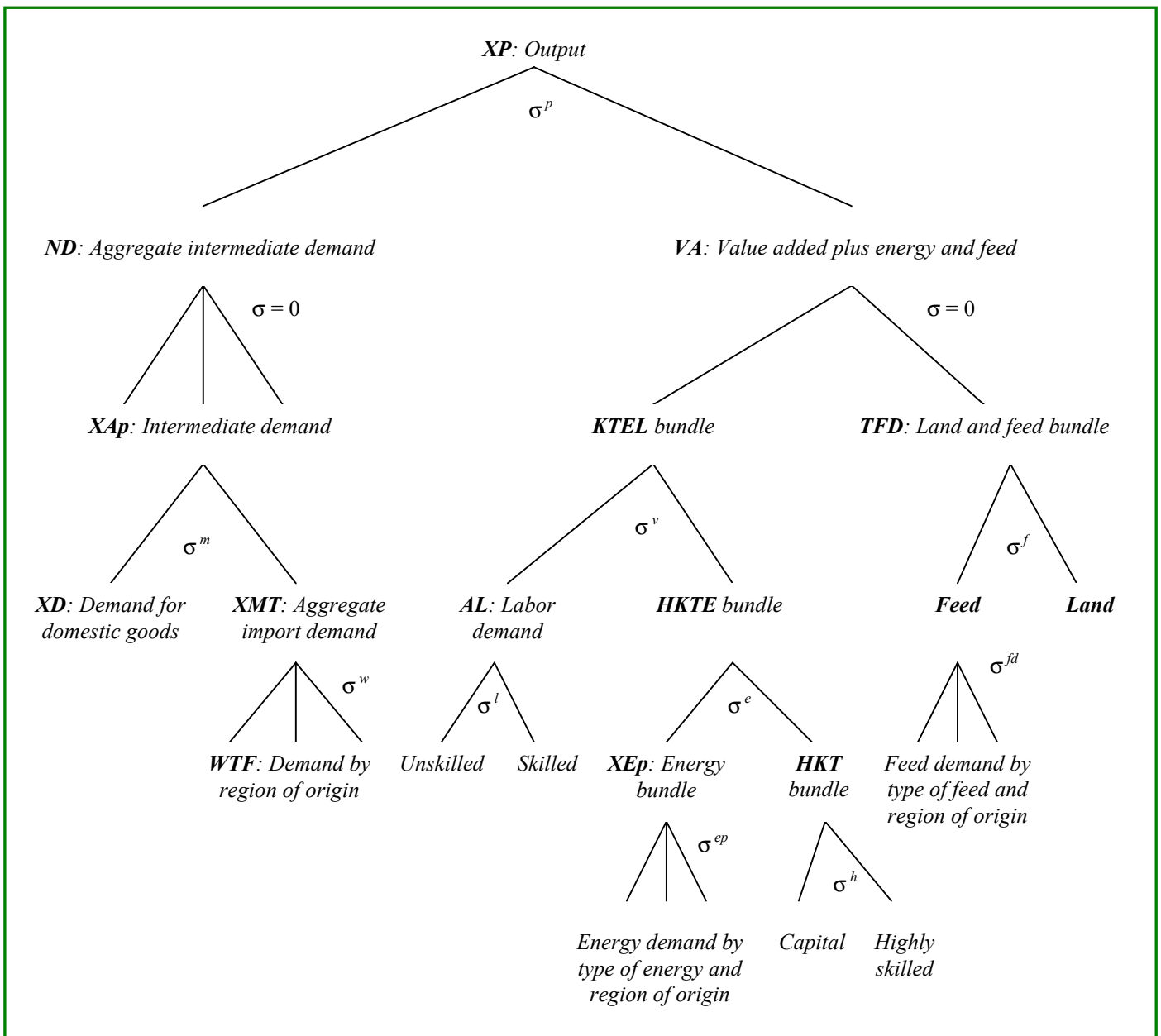


Figure A-3: Nested structure of all other goods production

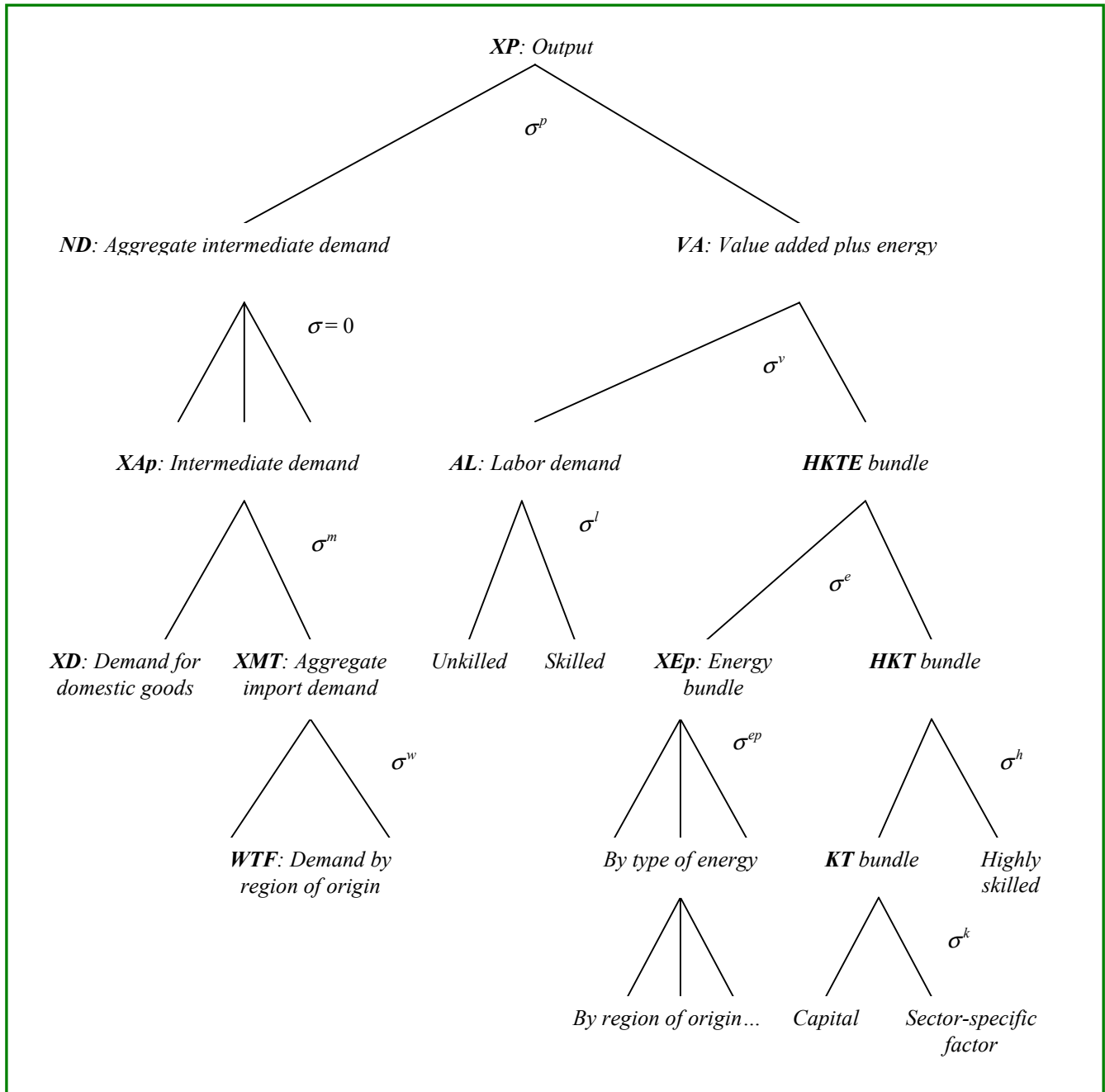


Figure A-4: Nested structure of supply and demand

